THE TAX INSTITUTE

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By email: Michelle.Dowdell@TREASURY.GOV.AU

Dear Michelle,

TTI Superannuation Reforms Priority List – Proposed solutions

We refer to the Superannuation Reforms Priority list we submitted to Treasury and the ATO on 21 June 2018 (refer Annexure A). We also refer to our meeting with Treasury and the ATO on 1 August 2018. During that meeting Treasury indicated that it would be interested in hearing suggested solutions in relation to the reform issues we raised in our Superannuation Reforms Priority list.

The purpose of this letter is to outline our suggested solutions in relation to the legacy pension issue raised in our Superannuation Reforms Priority List.

We submit that the legislation in relation to legacy pensions should be revised. We have listed our suggested solutions for Treasury's consideration below:

- Members should be permitted to convert legacy pensions to an account based pension (**ABP**). This may give rise to excess transfer balance cap (**TBC**) issues. We consider that legacy pensions should be allowed to convert to an ABP up to the amount of the member's available TBC. This would occur via the current system of commuting the legacy pension, then commencing an ABP and being tested for TBC purposes.

- Any amount supporting a legacy pension that is in excess of the member's TBC should be able to be commuted to form part of the individual's accumulation interest. For example, a lifetime pension valued at $3 million could be converted into the following — a $1.6m ABP and the balance of $1.4m can form part of the individual's accumulation interest.

- Where the legacy pension being commuted is a market linked pension (**MLP**) there are unlikely to be any reserves supporting such a pension as a MLP is an account style pension. However, with a lifetime, fixed term or flexi pension, there may be reserves that support the provision of these pensions. In some cases, these reserves may be considerable particularly with some lifetime or flexi pensions.

- The treatment of amounts in excess of the commutation of a flexi-pension should be modified. The ATO has expressed this on its website (ATO - Super Changes - Frequently Asked Questions):

  > *A trustee of a superannuation fund may hold assets in a reserve that supports a flexi-pension which exceed the maximum amount that may be commuted under regulation 1.06(6) of the SISR.*
  >
  > *Where the flexi-pension has been commuted in full, the trustee may (subject to the applicable trust deed) allocate the excess amounts from the reserve to all of the members of the fund in a fair and reasonable manner. Any allocation that is 5% or more of a member's total interest in the superannuation fund will be a concessional contribution and count towards the member's concessional contributions cap.*

Retaining reserves in the superannuation system means that the underlying amounts are concessionally taxed for as long as they remain 'locked up' in the superannuation system. The ATO's recently released regulatory bulletin SMSFRB 2018/1 seeks to preclude the use of reserves in an SMSF environment after 1 July 2017. However, there is a carve out in this ATO regulatory bulletin in respect of reserves – see the following extract from paragraphs [47] to [48] of SMSFRB 2018/1:

> ***Can I use a reserve in relation to a pension under regulations 1.06(2), 1.06(6) and 1.06(7) of the SISR?***
>
> *47. Accounts such as the 'pension account' and 'pension reserve account' described in ATO ID 2015/22 set up by an SMSF in relation to a pension that satisfies the requirements of subregulation 1.06(2), 1.06(6) or 1.06(7) of the SISR together comprise a 'reserve' for the purposes of regulation 291-25.01 of the ITAR 1997.*
>
> *48. SMSF trustees are able to maintain 'pension reserve accounts' while the SMSF continues to pay a pension that satisfies the requirements of subregulation 1.06(2), 1.06(6) or 1.06(7) of the SISR. The amounts in these accounts comprise an amount available to the trustee, not the member, to satisfy the trustee's liability to pay the complying pension.*

Allowing members to retain such reserves in the superannuation system, may result in less tax revenue for the Government compared to the situation if these moneys were invested outside the superannuation environment. A reserve attached to, or supporting, such pensions should be in practical terms considered a part of these pensions. This is to be contrasted with reserves created for other reasons (such as investment smoothing or anti-detriment reserves).

Therefore, our preferred option is that the legislation be modified to provide that where a fund has a reserve supporting, or related to, a lifetime, fixed term or flexi pension that is converted into an ABP (and/or accumulation interest) then the amounts in those reserves should be able to be converted into an ABP (and/or accumulation interest) without being counted for the member's contribution caps.

Alternative options include:

- the reserves could be allocated to the member as a non-concessional contribution (**NCC**) subject to the usual NCC caps but not the total superannuation balance limits (this is preferred if reserves are intended to stay in super).

- allowing reserves to be allocated without counting for the contributions caps but only if they are paid as lump sums out of the super fund (ie forcing these amounts out of the concessionally taxed super system).

Legislation should be amended to improve the integrity of legacy pensions. In particular, since legacy pensions all commenced before 31 December 2015, all legacy pensions are subject to the Centrelink concessions 'assets test'. We note that if the asset was bought:

- before 20 September 2004, it doesn't count towards the assets test (ie 100% exempt);

- after 20 September 2004 and before 20 September 2007, 50% of its value counts towards the assets test.

We note that there are similar issues with the Centrelink concessions regarding the 'income test'.

We recommend that the Centrelink concessions regarding the 'assets test' are preserved even when a legacy pension is converted into an ABP. We also recommend that the Centrelink concessions regarding the 'income test' are preserved when the legacy pension is converted into an ABP. Alternatively, where the legacy pension is converted to an ABP, we recommend that the ABP be concessionally treated as if it were started before 1 January 2015.

Without this concession it is likely that many members with such grandfathered legacy pensions would not take advantage of the ability to convert their pensions into ABPs. This would diminish the effectiveness of the new measure.

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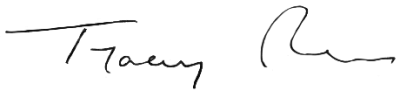
If you would like to discuss, please contact either me or Tax Counsel, Angie Ananda, on 02 8223 0011.

Yours sincerely



Tracey Rens
President

Priority	ATO or Treasury	Topic	Details	Suggested solution(s)
		TRIS		
1	ATO & Treasury	TRIS fixes	The law governing transition to retirement income streams (**TRIS**s) should be clarified and, if needed, fixed.	
			There is a proposal to allow TRISs to revert on death even though the reversionary beneficiary has not satisfied a relevant condition of release (draft legislation awaiting finalisation). This change is welcome but is not be needed based on the following view o	
			While the law appears clear (ie that a TRIS automatically converts to an account-based pension (**ABP**) on the member satisfying a condition of release with a nil cashing restriction if the governing rules allow such flexibility), the ATO argues that once an income stream is established as a TRIS it remains a TRIS. This view differs to that of certain sectors of the super industry (primarily those representing SMSFs) who have for a long time understood that the law converted a TRIS automatically to an ABP on the member satisfying a relevant condition of release. The industry view that a TRIS automatically converts to an ABP is detailed in the submission previously lodged by The Tax Institute. However, the ATO still argues that due to wording in the explanatory memorandum which accompanied the 2017 TRIS changes (to recognise a TRIS in retirement phase) that it does not. The ATO argues that once a TRIS, it is always a TRIS. This gives rise to unnecessary red tape and costs. Certain industry sectors have based their view on the law since mid-2007 and have been working with the practice of auto-conversion for many years (in fact the mid-2007 reforms encouraged auto-conversion from an allocated pension to an ABP and a TRAP to an ABP). It is acknowledged that some industry funds and APRA funds treat a TRIS as a separate product to a ABP and their systems are specified this way and do not facilitate auto-conversion. However, some of these funds may prefer to adopt an auto-conversion view and make system modifications to adopt the conversion of TRIS to ABP approact	
			Options should therefore be pursued for simplifying the TRIS provisions. One option would be to recognise the automatic conversion from a TRIS to an ABP and that simplifies the differentiation between the TRIS and the ABP. Under this option, there would be no need to compare a TRIS in retirement phase to one that is not. This would remove the distinction between a TRIS in retirement phase. Certain modifications to the *Corporations Act 2001* (Cth) may also be needed. Another option is to allow the ability to take lump sums after a member attains their preservation age - but before reaching a full condition of release. Such lump sums could be limited to 10% of the member's account balance each financial year (**FY**).	Recognise the automatic conversion from a TRIS to an ABP on satisfying a relevant condition of release. There would be no need to recognise a TRIS in retirement phase. This would simplify things and save on costs.
2	ATO & Treasury	TSB & TRIS interaction	Further, with the background above in mind (ie that once a TRIS, always a TRIS), this argument is now being relied on by certain advisers that argue that s 307-230 ITAA 1997 currently gives rise to a unintended loophole for members. Some are now arguing that their TRIS retirement phase balances are not counted towards their total superannuation balance (**TSB**) since a TRIS that is in the retirement phase is not expressly referred to in s 307-230(4). This sub-section currently only expressly refers to an ABP. However, the ATO take the view that ABP in s 307-230(4) does include a TRIS. The ATO's current position is causing uncertainty in the industry	Adopting the auto-conversion of a TRIS to an ABP would result in this issue being resolved.
		Legacy' pensions		
3	ATO & Treasury	Conversion option for 'legacy' pensions	Members should be able to convert market linked pensions (**MLP**) under SISR 1.06(8) and other pre-2007 pensions (such as lifetime, fixed term and flexi pensions) under SISR 1.06(2), (7) and (6)) to an ABP. Preferably members could preserve their Centrelink assets test exemption for such pensions in rela any replacement ABP. Any such conversions would be subject to the usual transfer balance cap (**TBC**) regime. We imagine that this would have no significant adverse affect on revenue but would provide a significant reduction to compliance costs and provide greater simplicity and flexibility moving forward. Although this only affects a relatively small number of members, it has a significant impact on those members many of whom are in their 'twilight years' and who have great difficulty comprehending the complexity of the 'legacy' products they now have.	Subject to certain integrity rules, allowing certain legacy pensions in SMSFs to be converted to an ABP.
	ATO & Treasury	Capped defined benefit income streams (**CDBIS**)	Legacy pensions amnesty paper which seeks to allow legacy pensions to transition to an ABP and to resolve technical issues with doing so. Similar to above issue.	
4	ATO to change view; if not then Treasury to clarify law	CDBIS - debits to TBA	ATO view of no debit on commutation of an MLP under s 294-145 of the ITAA 199	
5	ATO & Treasury	CDBIS & family law commutation	Family law commutations of an MLP under s 294-145 of the ITAA 199	
6	Treasury	MLPs and seeking a solution for ongoing excess TBA	Dealing with post-30 June 2017 MLPs where the purchase price results in the taxpayer exceeding their TBC and causing a 'continuing in excess' scenario as the law does not allow a commutation unless the ATO can direc	
		Reserves		
7	ATO & Treasury	Reserves	Enabling SMSFs to deal with pre-1 July 2017 reserves. The current laws are unsatisfactory for SMSFs that have reserves for historical reasons (eg for lifetime pensions and certain other reasons). For larger reserves, the 5% test and the counting of transfers from a reserve means that not much more than 5% can be transferred to members in any given year. This may mean that it will take many years to transfer some reserves. One possible solution for those with legacy pension reserves is to allow members to transfer these reserves out of the super environment without being counted for contributions (**CC**) cap (purposes. Another option is to allow transfers from these pre-1 July 2017 reserves to be counted against the member's non-concessional cap rather than their CC.	One solution is to allow members with a legacy pension to transfer reserves out of the sup environment without being counted for CC purposes
			SMSF RB 2018/1 was issued in March 2018 and the industry has still to comment on the ATO's view. Industry has raised its preliminary concern that the ATO is seeking to treat reserves for SISA purposes in a different manner to reserves for tax purposes. Many with legacy pensions previously commuted them pre-July 2017 and still have significant reserves and the ATO position in SMSF RB 2018/1 does not give them any comfort of being able to deal with these reserves in a timely ma	
8	ATO & Treasury	Operational risk reserve (**ORR**) adjustment	Exclude remediation amounts allocated to member accounts from an ORR from counting as CCs – the resulting taxes on excess contributions could be up to 95% (and further remediation also taxed at 95% to make good that tax). This means the ORR is unfit for the purpose it was intended.	Exclude remediation amounts allocated to member accounts from an ORR from counting CCs
9	Treasury	Defined benefit guarantee top-ups	Exclude defined benefit guarantee top-ups from counting as CCs – these were guarantees employers gave often in the 1980s and 1990s well before contribution caps were contemplated that the member would not be worse off by agreeing to move from defined benefit to accumulation accounts (which are cheaper to administer). However, if the guarantees are called on many years later when the employee retires, it can cause an enormous contributions tax liability equal to 95% of the top up (which then requires further top ups that are each taxed at 95%). It mostly affects maritime and construction industry employees.	Exclude defined benefit guarantee top-ups from counting as CCs
		Superannuation guarantee (SG)		
10	Treasury	SG - opt out	Broadly, members with incomes above $263,157 with multiple employers will soon be empowered to decide whether certain employers do not need to provide SG contributions in respect of their wages from 1 July 2018 (assuming the May 2018 Budget announcement is enacted). While this is a positive and long overdue measure, we consider that an administrative solution is required given the 1 July 2018 commencement date.	An administrative solution is required to deal with the documentation issues given the 1 July 2018 commencement date.
11	Treasury	Moderate the penalty regime for late SG contributions	The SG laws should be changed to enable voluntary rectification by employers or to give the ATO the discretion to permit such rectifications. This would allow employers who have made an honest and reasonable error to rectify their error. Employers should be allowed to voluntarily rectify by making late contributions with interest but without any penalty and without lodging an SG statement.SG penalties should be aligned with other taxes. Late contributions should remain tax deductible, continue to be calculated on the basis of ordinary time earnings (not salary and wages). Further, the late payment interest should be the shortfall interest charge grossed up for 15% contributions tax (ie 5.61% rather than the current 10% which is excessive) and be calculated from the 28th day after the end of the quarter (not the start of the quarter) until the payment is made (ie not until when the SG statement is lodged). Director liability, criminal sanctions and imprisonment for errors and insolvency are unreasonable unless these are confined to the extreme cases. SG statements should no longer be required given single touch payroll reporting and the $20 administration fee should only be charged where the late contributions are paid to ATO for it to disburse to employees' superannuatior	
12	Treasury	SG 'notional earning base'	Reinstate the SG 'notional earning base' for employees covered by industrial instruments so that pay components on which SG is owed can be clearly bargained for thereby reducing the current level of SG litigation and disputes, and ensure that where employees are paid. annualised or aggregated pay rates designed to cover all industrial entitlements that the underlying pay components are still recogni	Reinstate the SG 'notional earning base' for employees covered by industrial instruments.
			The recent Federal Court decision in Australian Workers' Union v BlueScope Steel (AIS) Pty Ltd [2018] FCA 80 has important implications for when employers need to pay superannuation contributions to employees in respect of additional hours and public holidays. The Federal Court held that the employe have made SG contributions in respect of the "additional hours" and "public holidays" components of salaries under the terms of the agreement between BlueScope Steel and its employees where the employees were required to work additional hours as well as work on public holidays. The Bulk Operations Enterprise Agreement 2005 (for example) requires employees to work "additional hours" and on "public holidays" as the norm that underpins the recognition that those employees can only fairly be remunerated by reference to an 'annualised salary', said Federal Court judge, Justice Geoffrey Flick. Broadly, resulted in additional hours of work to being treated as ordinary time earnings (**OTE**) despite the Enterprise Agreement between the company and its employees suggesting they were additional hours. The Court said hours which are worked beyond standard or fixed hours may become such that they become the "ordinary hours" of an employee. This case has potentially wide spread ramifications and the concept of 'OTE' for SG purposes may result in a considerable number of other employees now being exposed to SG on the amount of salary and wages they pay to their employees rather than just OTE.	OTE should not cover additional hours or overtime hours.
13	Treasury	Expat employee SG clarification	Clarify that SG is not applicable to expatriate employees on wages that are not subject to PAYG withholding	Exclude wages paid to expatriate employees that are not subject to PAYG withholding from SG.
		Foreign fund transfers to Australian super funds		
14	Treasury	Foreign fund transfers to Australian super funds	Fixing up the current regime for foreign fund transfers to Australian super funds. While there is some difficulty achieving the right balance between facilitating this and fitting within Australia's restrictive superannuation regime. One option would be to treat foreign fund transfers as a special form of contribution with special cap – similar to the ability to make contributions under the capital gains cap (small business tax concessions). This could be capped to people who have total super balance of less than $1.6 million. Also the eligibility for foreign funds should be widened (eg to include certain USA 401k funds that may not currently qualify).	Provide more flexibility subject to certain caps and integrity rules to transfer super savings from foreign super funds.
			We would prefer to focus on more alignment with UK transfers rather than US transfe	
		Sundry technical issues		
15	Treasury	Residency status for SMSFs	An SMSF can easily fail the 'Australian superannuation fund' test in s 295-95(2) ITAA 1997 with substantial tax implications. There is currently no ATO discretion to allow the Commissioner to ignore such failures. Therefore, the test needs to be made more appropriate for SMSFs as the current tests are difficult and have no flexibility if breached. Further, if an SMSF is rendered non-complying as a result of failing the 'Australian superannuation fund' test, there is a further tax penalty on such a fund gaining its 'Australian superannuation fund' test residency back. In these circumstances, why would such a fund want to resume being an 'Australian superannuation fund' test only to receive another tax penal	Delete the need for the active member test and provide an alternative to the central management and control test subject to certain provisos.
16	Treasury & ATO	Notices of deduction of personal contributions	The requirements for **notices of deduction** of personal contributions should be simplified and greater flexibility provided. For example, relief needs to be provided when mistakes are made in completing the notices especially as more notices will be used given the abolition of the 10% employee test. The ATO have been working on a proposal where the member can claim the deduction in their personal tax return and the fund is then notified to adjust for any tax payable. The integrity measures announced in the May 2018 Budget may partially resolve some of these	
17	Treasury	Untaxed element calculation triggered on a rollover of a death benefit	We submit that the untaxed element in s 307-290 ITAA 1997 should be deleted in respect of taxed superannuation funds given the mid-2017 legislative changes and particularly given the reduced opportunity for claiming insurance in SMSFs. If however the untaxed element is not removed, then at least the calculation triggered on a rollover of a death benefit to commence an income stream with another provider requires adjustment so no untaxed element arises on roll-over. Broadly, this will result in largely only public sector funds only having to deal with an untaxed	
18	Treasury	Binding death benefit nominations (**BDBN**)	The SISA/SISR provisions relating to BDBNs are according to the *Retail Employees Superannuation Pty Ltd v Pain* [2016] SASC 121 case unworkable and in urgent need of repair. This case contains extensive commentary on the BDBN provisions in the SISA and SISR by the SA Supreme Court. The court called for reform in this area at [512]: The structure and drafting of sections 58 and 59 of the SIS Act and regulation 6.17A of the SIS Regulations give rise to ambiguities, uncertainties and potentially unintended consequences … It is highly desirable that those provisions be reviewed by the Commonwealth and recast. There are now two supreme court decisions that confirm the view that the SISA/SISR provisions regarding BDBNs do not apply to SMSFs provided the deed is appropriately worded (*Mercuro v Munro* [2015] QSC 61 and *Cantor Management Services Pty Ltd v Booth* [2017] SASCFC 122). Many SMSF deeds are not appropriately worded and as a result most BDBNs simply do not stand up to any legal challenge. Further, many BDBNs do not work for both large and SMSFs and consumers have BDBNs that do not work. Further, recently ASIC found many financial planners backdating and signing BDBNs when they were not present at the execution by the client. Lawyers should be the only ones who can provide legal advice and legal documents affecting the legal rights of members. Non-legally qualified persons should refrain from seeking to prepare SMSF deeds and BDBNs unless they are qualified under the relevant state or territory in which the service is rendered. The Australian Law Reform Commission also recommended, among other things, that an attorney under an enduring power of attorney should not be able to vary a member's BDBN and an annual disclosure/review in relation to a member's succession be considered.	Provide clarity that the BDBN provisions are effective to make a BDBN that will not be undermined by legal challenges as per the REST decision.
18A	ATO	Making an ABP auto-reversionary via a BDBN	Making an ABP automatically reversionary via a BDBN	Confirm the ability for a BDBN to make a pension auto-reversionary - given ATO comments in LCR 2017/3 para 15.
19	Treasury	Non-geared unit trusts & companies		Greater flexibility provided for rectifying minor transgressions of the tests in div 13.3A of SISR
20	Treasury & ATO	Life interest pensions	An SMSF can invest in a SISR 13.22B & 13.22C non-geared unit trust or company provided certain criteria is satisfied. However, if any criterion is contravened the units or shares acquired under that relief will cease to be covered by the exception and will become an in-house asset. This may arise for a range of issues and the downside of contravening far outweighs the nature of the breach which may be minor and an honest oversight. For example, having an unpaid present entitlement for more than 12 months, going slightly into overdraft due to a bounced cheque or for a debit loan due to a related or third party expense on behalf of the unit trust or company. The downside of these technical breaches is far too onerous and some flexibility should be provided to rectify within a given p	Recognise life interest pensions
			Life interest pensions - broadly to allow pensions to revert to a surviving spouse and then for any remaining capital to go to children from a former relation	