THE TAX INSTITUTE

28 March 2019

Retirement Benefits Unit
Retirement Income Policy Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: superannuation@treasury.gov.au

Dear Sir/Madam

Transfer Balance Account Reporting (TBAR) amendments

The Tax Institute welcomes the opportunity to make the following submission to Treasury as part of consultation on the Exposure Draft (**ED**) *Treasury Laws Amendment (Miscellaneous Amendments) Bill 2019* (**Bill**) and *Treasury Laws Amendment (Miscellaneous Amendments) Regulations 2019*.

Background

In general, retirees face a $1.6 million cap on the amount they can use to purchase a tax-free superannuation pension. Existing retirement pension balances on 1 July 2017 (being the date TBAR was introduced) also count towards that cap.
The transfer balance account is maintained to keep track of the remaining cap space for the retiree, with:

- a *credit* arising when a member starts to receive a pension in retirement phase, and on 1 July 2017 for existing pensions in retirement phase; and
- a *debit* arising when a member receives a lump sum in part or full commutation of the pension.

In recognition that it is difficult to bring the value of some pensions down to the cap, additional cap space is provided to allow for the full *credit* value of:

- defined benefit lifetime pensions; and
- life expectancy pensions and account-based market-linked pensions that were already in existence in retirement phase on 1 July 2017.

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These types of pensions were (in the most part) not account-based, so special values were used to work out the *credit*. For whatever reason, a special value was also used for the 1 July 2017 value of account-based market-linked pensions.

Unfortunately, the interaction of the *credit* and later *debit* upon commutation did not always produce sensible outcomes. The Bill and Regulations are intended to rectify the position for account-based market-linked pensions and in some other situations.

Main Submissions

The Tax Institute submits that the Bill and Regulations require further work to achieve their objective. Further, the interim pragmatic administrative practices superannuation funds have been adopting to date need to be catered for.

In particular, The Tax Institute submits that:

1. the *debit* for commuting or partly commuting a life expectancy pension or account-based market-linked pension that was already in existence in retirement phase on 1 July 2017, should be the greater of (i) the original *credit* reduced by any preceding *debits* for that pension and a further proportional reduction for a part commutation, and (ii) the actual lump sum drawn;
2. the *credit* for a successor fund transfer, and for a replacement of a defined benefit pension, should be made to explicitly match the *debit* that also arises at that time where the pension benefits do not change as a result of the transfer or replacement;
3. section 307-290 of the *Income Tax Assessment Act 1997* (**ITAA 97**) should be amended to prevent an untaxed element from arising on a death benefit rollover, instead of having to deal with the consequences if it does arise by making the element tax free to the recipient fund through amendments to section 295-190 of the ITAA 97; and
4. if our submissions are not adopted, at a minimum there should be a waiver for interest charges and penalties for any resulting underreported and underpaid tax for the past and for a reasonable period of time to enable superannuation funds to make the necessary alterations to their systems and report the changes to the ATO.

Explanation and Other Submissions

a) Account-based market-linked pensions

A <u>standard</u> account-based pension has a minimum annual drawdown percentage based on age. By contrast, an account-based market-linked pension has a fixed draw down percentage based, in broad terms, on the remaining life expectancy.

For a standard account-based pension the *credit* is the initial withdrawal value, and the *debit* is the actual lump sum later withdrawn. That provides a sufficient *debit* for accrued undrawn earnings that added to the pension account balance to be rolled over into another standard account-based pension without using up any additional cap space (ie no net *credit* arises upon pension commutation and restart).

However, the Bill does not provide any *debit* for accrued undrawn earnings rolled out of an account-based market-linked pension. That means purchase of a replacement account-based market-linked pension using just the lump sum proceeds from the original pension is not possible without using up additional cap space. The *credit* for the replacement pension is larger than the *debit* for the existing pension that is commuted. The Tax Institute submits that the *debit* on commutation of a pre-1 July 2017 account-based market-linked pension should be at least equal to the lump sum actually drawn to enable a replacement account-based pension to be purchased using the whole of that lump sum without using up additional cap space.

This approach also accords with ATO reporting requirements that existed at the time under which the ATO required the *debit* on commutation of an account-based market-linked pension to equal the account balance drawn. In short, ATO reporting required commutation of an account-based market-linked pension to be treated in the same way as commutation of a standard account-based pension.

No penalty or adverse tax consequences should be applied to the funds or the members for having adopted that approach. If Parliament still wishes for superannuation funds to now depart from that existing reporting approach, it needs to be recognised that practical implementation will be complex involving data that needs to be drawn from multiple systems. It can be expected to take up to six months for funds to re-report.

b) Defined benefit pensions

The issue of ensuring there is no net *credit* on pension commutation and restart also arises for indexed defined benefit lifetime pensions.

The *credit* on commencement of a defined benefit lifetime pension is the annual payment times 16, and the *debit* on full commutation is the same amount (assuming there has not been any preceding part commutation).

However, if the pension payments have been indexed, the higher annual payments will mean that the *credit* for the replacement defined benefit pension will exceed the *debit* for the defined benefit pension that ended. The Tax Institute submits that this imbalance should also be rectified by the Bill.

c) Successor fund transfers (SFT)

Existing pensions ordinarily continue to be paid after an SFT from the successor fund without any change to the benefit terms. In short, the same pension legally continues. The commencement date of the pension remains unchanged.

Demonstration that that is indeed the case is that the trustee of the successor fund is liable to the member for any previous pre-SFT underpayment of the pension going back to the original commencement date. If it were a new pension post-SFT, the trustee of the successor fund would not have that liability and would rather only have a liability for pension payments due from the date of the SFT.

Further demonstration that the same pension remains ongoing is that no pension money is transferred back into an accumulation phase account, even momentarily, as would be a necessary precondition for a second pension to commence post-SFT.

The Tax Institute therefore submits that an SFT does not give rise to a *debit* for pension commutation nor a *credit* for a pension restart that needs to be reported in TBAR. The preceding issues discussed in this submission about *debits* and *credits* not matching on a pension commutation and restart therefore do not arise on an SFT.

Nevertheless, The Tax Institute can understand that the ATO may still wish for a *debit* and *credit* to be reported for efficient operation of its record keeping systems given the change in the fund USI key for member accounts. However, that is not a legal reason to treat an SFT as a pension stop and restart. Rather, it is a reason to add an SFT as a separate transfer balance account reporting event (and in doing so ensure that the *debit* and *credit* match).

Accepting that a pension entitlement continues uninterrupted on an SFT also has the added advantage of overcoming two other issues faced where an SFT occurs mid-way through a financial year. First, the mandated minimum annual pension drawdown does not need to be split into two part years, nor recalculated for the second part-year. Second, a defined benefit pension interest will have only a single *notional taxed contribution* for the year capped at the grandfathered $25,000, rather than potentially double the *concessional contributions* cap. Currently, both of these issues may adversely impact members in an SFT unless managed as a compensatory cost borne by the trustees.

d) Step down in defined benefit pensions

The Tax Institute welcomes the change in the Regulations to recognise a *debit* when the annual payments from a defined benefit pension step down. That can occur for example when a defined benefit pension reverts to the spouse, or when one of the children reaches adulthood.

e) Death benefit rollovers

The Tax Institute welcomes the change in the Bill to exclude the untaxed element that can arise on a death benefit rollover from being taxable to the recipient fund under s. 295-190 of the ITAA 97. However, it would be administratively simpler if the amendment stopped the untaxed element arising in the first place on a rollover of a death benefit by amending s.307-290 of the ITAA97.

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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

Tim Neilson

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President