17 April 2023

Director
Tax and Transfers Branch
Retirement, Advice and Investment Division
The Treasury
Langton Crescent
Parkes ACT 2600

By email: superannuation@treasury.gov.au

Dear Director

BETTER TARGETED SUPERANNUATION CONCESSIONS

This submission has been prepared by the Superannuation Committee of the Law Council of Australia's Legal Practice Section. The Committee welcomes the opportunity to make a submission to the Treasury in relation to the proposals for "Better targeted superannuation concessions" contained in the Treasury's Consultation paper dated 31 March 2023.

As you will be aware, the committee is made up of experienced superannuation lawyers who, outside of the Superannuation Committee, advise a broad cross section of Australia's large superannuation funds. We endeavour to comment on almost every proposed reform to superannuation law. We focus on legal rather than policy issues with a view to ensuring that superannuation law is clear and operates without unintended consequences.

References in this submission to 'we' are references to the Superannuation Committee.

Our submission provides comment on implementation aspects of the proposed measures which in our view give rise to legal concerns and, where appropriate to our role, we also comment on the specific consultation questions contained in the Consultation paper.

Comments on implementation aspects of the proposed measures—legal issues in implementing additional tax on individual superannuation "balances" exceeding $3 million.

Promoting member confidence and acceptance

We note it is the intended policy to minimise any additional, administrative and reporting burden on funds and therefore potential additional cost to members generally in imposing the new measures. These are measures that in practice, at least initially, are only expected to impact a small cohort of superannuation members.

In that regard we note that Australian Prudential Regulation Authority (**APRA**) regulated funds, in respect of member accumulation interests, are already required to report annually to members, in periodic statements, annual "earnings" and "fees, taxes and premiums". However, it would appear that the proposed mechanism of deriving the

relevant Total Superannuation Balance (**TSB**, noting that TSBs include adjusted TSBs, being the TSB adjusted at year end for withdrawals and contributions) and applicable high balance earnings to tax will be derived differently from those metrics.

Sound law should be fair, readily understandable, and predictable in its application to an ordinary person. This is especially the case in taxing of individuals, and should have regard to the existing complexity in superannuation. Criteria of simplicity in implementation and sector neutrality, while supported in principle and likely to be efficient, do not necessarily translate into law that is effective and enduring in terms of understanding and acceptance for the affected individual. Any implementation measures should expressly consider that aspect in their design, otherwise there is a risk that members will lose confidence in the superannuation system through further complexity and what may be seen as "incomprehensible" taxing rules—especially in regard to members with defined benefit (**DB**) or pension interests or in new innovative retirement products intended to encourage greater self-provisioning by members against longevity risk and reduce the burden on the age pension.

We accept that, for affected members with DB interests, there will need to be estimates made as a proxy for earnings on those interests which currently do not apply in any member reporting.

Changing the rules for the basis upon which individuals have invested in superannuation for retirement

While accepting that the consultation is in regard to implementing the announced policy and we are not commenting on the policy itself, we note the measures do give rise to concern that the fundamental basis upon which members make and have made investment decisions for retirement savings is being altered (including for members who are not currently at the $3 million proposed limit but will inevitably exceed that limit given no indexation of the limit is proposed).

For members with DB interests that will in future be payable as pensions or that are already in the pension phase, they are not necessarily in a position to adjust their affairs to take into account the new measures.

For other members, personal long-term investment choices have been made between superannuation and other options, those monies that have been directed into superannuation savings have been subject to preservation and other superannuation regulatory restrictions over the longer term on the reasonable expectation of the investor that those restrictions represented the cost or trade-off for long term tax concessions. Now, a change to the taxation rules would retrospectively affect that 'trade-off' because the tax concessions upon which the decision was based are to be impacted.

As a Committee, we recognise it is the Government's prerogative to propose reform measures affecting the taxation treatment of superannuation. However, there is an attendant risk in so doing; being that the community will view the superannuation taxation rules as somewhat "fluid" and may be disinclined to choose superannuation as a preferred investment vehicle for discretionary savings. As such, one of the important tenets of the superannuation system of incentivising savings for retirement may be damaged.

Comments on consultation questions

1.Do you consider any further modifications are required to the TSB calculation for the purposes of estimating earnings? If so, what modifications should be applied?

APRA regulated funds are already required to report to members annual earnings, tax, fee and insurance premium costs information in member periodic statements. Any additional tax impost should be consistent with that reported information—i.e., so that affected members may readily understand the basis upon which the additional tax has been calculated.

Alternatively, if the proposed TSB methodology is adopted—with the netting off of the impact of withdrawals and contributions on starting and ending balance to leave a residual "net earnings" figure—then Australian Taxation Office (**ATO**) assessment notices to members will need to clearly identify the relevant inputs used to derive the calculations involved for an individual as well as the methodology applied, so as to minimise the prospect of member dispute with individual funds concerning the reporting to the ATO that has occurred.

This is especially the case where an affected individual holds multiple superannuation interests, including any DB interests and interests in the retirement phase.

We note it is proposed to provide a mechanism for affected individuals once they exceed the $3 million TSB to carry over any negative earnings to future years to offset against future taxable earnings. This complexity may be avoided by instead providing for a tax refund to be available for the individuals concerned in the relevant period.

2. What types of outflows (withdrawals) should be adjusted for and how?

Assuming this is the methodology applied, withdrawals should include all payments out (of any description), including fees, taxes and premiums.

3.What types of inflows (net contributions) should be adjusted for and how?

It may be necessary to apply a special purpose "contribution" definition to achieve the intended result with sufficient clarity. This would ensure that the following are all captured: contributions/applications made from reserves; notional contributions of any kind; amounts rolled in (including from overseas qualified recognised overseas pension scheme payments); insurance proceeds; and structured settlement payments etc.

4. Do you have an alternative to the proposed method of calculating earnings on balances above $3 million? What are the benefits and disadvantages of any alternatives proposed including a consideration of compliance costs, complexity and sector neutrality?

We refer to our opening comments above in relation to this question. In our opinion, any methodology used should include fairness to affected individuals and simplicity in being able to communicate the application of the tax and inputs used (estimated) involved.

5. What changes to reporting requirements by superannuation funds would be required to support the proposed calculation or any alternative calculation methods?

We refer to our opening comments above in relation to the existing reporting regime. We expect that the proposed methodology will need to include additional reporting to members/taxpayers in order that they are able to understand the basis for any additional

tax on earnings. However, it may be that the Australian Tax Office will be able to provide relevant information to members/taxpayers and it need not be an additional burden for trustees of funds (who would not necessarily know a member's overall TSB in any event). We expect there will be additional reporting required by trustees to the ATO in order that relevant information can be ascertained, particularly in relation to express inclusions and exclusions from the TSB.

6. Do you consider any modifications are required to the proposed proportioning method? If so, what modifications should be applied?

In relation to the approach proposed for the TSB and adjusted TSB, we consider that the proportioning method appears satisfactory.

7. Do you have an alternative to the proposed proportioning method? What are the benefits and disadvantages to any alternatives, including a consideration of compliance costs, complexity and sector neutrality?

No comment.

8. Does the proposed methodology for determining the tax liability create any unintended consequences?

We consider that there may be a risk of a community perception that Parliament may now be willing to assess other taxes by reference to a taxpayer's unrealised gains. The Committee understands that it has been a general principle of the imposition of taxation not to tax unrealised gains. To do so in this instance in order to ensure the new regime is relatively simple, means that there is a risk that the long-held taxing principle will have been lost. Further, questions may then be posed before the Courts as to whether taxation can be imposed on a taxpayer on the basis of what might be viewed as amounting to nothing more than a notional or theoretical gain.

9. Do the proposed options for paying liabilities create any unintended consequences?

Legitimate liquidity concerns may arise even for accumulation interests for which there is no accommodation or adjustment proposed. We suggest that application of the new measures for individuals in retirement phase products (including legacy pensions) may benefit from some flexibility in options for the application of the relevant tax.

10. Do the existing valuation methods for defined benefit interests in the pre-pension phase (under the existing TSB definition) work appropriately for the purpose of calculating superannuation balances over $3 million?

As noted in the Consultation paper, existing valuation methods have not been designed for the purposes of the new tax and may lead to unintended results. However, we consider that existing family law valuation factors and methodologies may provide a reasonable basis upon which to proceed provided that the burden of member-specific calculations is borne by the ATO/Government actuary having regard to relevant reporting

from the affected funds—noting the Government already has record of those DB funds for which non-standard family law valuation factors have been approved.

11. Do the existing valuation methods for defined benefit interests in the pension phase provide the appropriate value for calculating earnings under the proposed reforms?

No comment—although we are aware that Treasury has convened a specialist actuarial group to consider these matters, and we are supportive of that approach given the complexities involved.

We note that special consideration will also be required for calculating earnings in respect of new innovative retirement products.

12. Are there any alternative valuation methods that should be considered for either pre-pension or pension phase defined benefit interests?

No comment, as per our answer to the previous question.

13. Are there any preferred options in providing commensurate treatment for defined benefit interests?

We refer to our opening comments above concerning understanding and confidence in the new measures, and fairness and clarity from an individual member's perspective. We suggest that worked examples for members with DB interests and in pre- and post- retirement phase ought to be provided and tested on the relevant audience.

14. What are the benefits and disadvantages to any alternatives?

No further comment—we are aware that Treasury has convened a specialist actuarial group to consider these matters, and we are supportive of that approach given the complexities involved.

15. What would be the most effective method for collecting the required information? What are the benefits and disadvantages for the method identified, including a consideration of compliance costs, complexity and sector neutrality?

The Committee suggests that superannuation funds and administrators will be better placed to respond to this question.

The Committee would welcome the opportunity to discuss this submission with the Treasury. In the first instance, please contact the Superannuation Committee Chair, Natalie Cambrell on ncambrell@khq.com.au.

Yours sincerely

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Chair, Legal Practice Section