



THE TAX INSTITUTE

THE MARK OF EXPERTISE

20 October 2014

Mr Brant Pridmore
Manager
Benefit and Regulations Unit
Personal and Retirement Income Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: superannuation@treasury.gov.au

Dear Mr Pridmore,

Providing certainty for superannuation fund mergers – exposure draft legislation

The Tax Institute welcomes the opportunity to make a submission to Treasury in relation to *Tax and Superannuation Laws Amendment (2014 Measures No. 7) Bill 2014: Providing Certainty for Superannuation Fund Mergers (Exposure Draft)*.

Our submission addresses extending the scope of the Exposure Draft to internal voluntary transfers, and provides comments on other more technical issues.

Legislative references in this submission are to the *Income Tax Assessment Act 1997* unless noted otherwise.

Legislative objectives

The original Government legislative announcement as recorded in Government papers¹ included:

- a statement that the legislation would “ensure superannuation fund members are not disadvantaged where their benefits are rolled over within a fund or between funds in response to the *Stronger Super* package”; and
- an acknowledgement that the proportioning rule (i.e. the rule in s.307-125 about the proportion of a *superannuation benefit* drawn as tax free component versus taxable component) was both inappropriate and not intended to apply to transactions outside member control (i.e. involuntary transfers), and that new legislation will clarify and ensure that the rule does not apply to those transactions.

¹ Press Release from the Minister for Financial Services & Superannuation dated 22 October 2012, combined with the Mid-Year Economic and Fiscal Outlook 2012-13 at page 178.

We understand that the announcement was in response to the ATO's interpretation that an involuntary transfer of benefits as part of a successor fund transfer needs to be recognised as a *superannuation benefit* to which the proportioning rule applies to effectively cap the value of tax free component at the then value of the interest (**the ATO approach**).

The Tax Institute supports the legislative objectives in the original Government announcement.

Proposed amendments to the Exposure Draft

Extend Exposure Draft to internal involuntary transfers

Internal involuntary transfers within a *superannuation plan* (e.g. within a *superannuation fund*) are not given the protection provided by the Exposure Draft, but should be.

These transfers could be equally impacted by the ATO approach through being deemed to be payments under s.307-5(8) and then deemed to be *superannuation benefits* through s.307-15(2)(a). Deleting the word "another" from references in the Exposure Draft to "another superannuation fund" may be enough to extend the necessary protection to them. That would also then accord with the drafting of s.306-10 for normal *roll-over superannuation benefits*. At the very least, the Explanatory Memorandum should clarify the position for internal involuntary transfers.

Transitional rules needed for pensions that commenced pre-1 July 2007

Transitional rules should be added so these pensions continue to use the same tax free proportion as immediately before an involuntary transfer, not the tax free component from when they originally commenced.

Pensions that commenced pre-1 July 2007 didn't have a 'tax free component' (as defined) when they commenced. The concept of a 'tax free component' only applied from 1 July 2007 and would have been calculated for these pensions just before then, but may have subsequently changed due to a subsequent 'trigger event'.

Some pensions, most notably many invalidity pensions and child pensions (e.g. paid to orphans), may not have reached a trigger event. The transitional rules should clarify that an involuntary transfer is not a trigger event for these pensions and that the tax free component will still be recalculated in accordance with the existing transitional rules if and when the first trigger event does occur.

Extend proposed legislative change for the crystallised segment calculation (s.307-225) also to trigger events

Although probably very rare because it was pre-GFC, we note that the Exposure Draft will in principle allow a 30 June 2007 *crystallised segment* to exceed the then value of the interest. We suggest that a similar change be made for a trigger event calculation

under s.307-125(6) of the *Income Tax (Transitional Provisions) Act 1997* where GFC losses may be more relevant. The Explanatory Memorandum should also include a meaningful example.

Reducing the dollar value of the tax free component, contributions segment and crystallised segment

Tracking reducing dollar value of tax free component not relevant for pensions:

The note to s.307-210 says that the tax free component of the interest is reduced by the tax free component of each benefit paid. This is obviously sensible to do for non-pension interests. However, elevating the note into the section means it also needs to be complied with for pensions which is inappropriate and may create unnecessary record keeping because pensions use a tax free proportion rather than a tax free dollar amount.

No need to separately track reduction of contributions segment and crystallised segment: In a similar vein, when reducing the tax free component, we cannot see any practical need to introduce a requirement to identify and track whether the *contributions segment* or *crystallised segment* is being reduced.

The reasons for these two proposed changes are not explained in the Explanatory Memorandum. If these changes are (contrary to our submission) to be retained in the Bill then we ask that the rationale for them please be explained in the Explanatory Memorandum. Also, a meaningful example in the Explanatory Memorandum of how a benefit to which Reg 995-1.03 applies after these two changes would be helpful.

Pending terminal illness and death benefits need relief too

The position of members suffering terminal illness (where the benefit does not need to be immediately drawn) and death benefits where payment is pending but not processed at the time of the involuntary transfer should be considered. Benefits in these circumstances cannot be rolled-over and therefore won't meet the definition of *roll-over superannuation benefit* or the proposed definition of *involuntary roll-over superannuation benefit*. We submit that the Bill (or at least the Explanatory Memorandum) should provide clarification that an involuntary transfer undertaken during that time does not result in a loss of tax free component, or any benefits or contributions taxes.

Apply amendments from 1 July 2007, or at least 1 July 2014

The legislative changes proposed in the Exposure Draft address a potential disadvantage for some superannuation fund members that arose from the ATO approach to the *Simpler Super* legislative changes that took effect on 1 July 2007. In line with the stated objective of promoting certainty, we therefore suggest that the Exposure Draft have application from 1 July 2007.

While we appreciate that the ATO has (in short) agreed not to take action to review cases affected by this interpretational issue for the interim period prior to the application date of the Bill, legislation with the force of law that covers the interim

period is we submit still preferable. This is particularly so because calculation of the tax free component following an involuntary transfer that has already occurred is not a historical issue only, but retains relevance until the member's benefits are ultimately drawn from superannuation.

At the very least, we suggest that the Bill apply from 1 July 2014 so that fund mergers that are currently under consideration might gain the greater certainty provided by the Bill.

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If you would like to discuss any of the above, please contact either me or Tax Counsel, Thilini Wickramasuriya, on 02 8223 0044.

Yours sincerely

A handwritten signature in black ink that reads "M. Flynn" followed by a long, horizontal, slightly wavy flourish.

Michael Flynn
President