SMSF Association

Budget Submission 2018 - 2019

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Adelaide SA 5000

ABOUT THE SMSF ASSOCIATION

The SMSF Association is the peak professional body representing the self managed superannuation fund (SMSF) sector which is comprised of over 1.1 million SMSF members who have $701 billion of funds under management and a diverse range of financial professionals servicing SMSFs. The SMSF Association continues to build integrity through professional and education standards for advice and education standards for trustees. The SMSF Association is consisted of individual members, principally accountants, auditors, lawyers, financial planners and other professionals such as tax professionals and actuaries. Additionally, the SMSF Association offers SMSF members a membership category which allows them access to independent education materials to assist them in the running of their SMSF.

OUR BELIEFS

- We believe that every Australian has the right to a good quality of life in retirement.
- We believe that every Australian has the right to control their own destiny.
- We believe that how well we live in retirement is a function of how well we have managed our super and who has advised us.
- We believe that better outcomes arise when professional advisors and trustees are armed with the best and latest information, especially in the growing and sometimes complex world of SMSFs.
- We believe that insisting on tight controls, accrediting and educating advisors, and providing accurate and appropriate information to trustees is the best way to ensure that self-managed super funds continue to provide their promised benefits.
- We believe that a healthy SMSF sector contributes strongly to long term capital and national prosperity.
- We are here to improve the quality of advisors, the knowledge of trustees and the credibility and health of a vibrant SMSF community.
- **We are the SMSF Association.**

FOREWORD

The SMSF Association welcomes the opportunity to make a pre-budget submission for the 2018-19 Federal Budget. As leaders of the SMSF sector, we believe we are able to offer insights on some key issues from the perspective of an industry that has grown to represent approximately $701 billion in assets and over 1.1 million SMSF members, becoming an integral part of Australia's superannuation system and economy.

This year our submission focuses primarily on improving the efficiency of the superannuation system.

After the introduction of the significant legislative changes which came into effect on 1 July 2017, it is essential that superannuation fund members continue to have a period of stability. We note the Government has stated they have no intent on any further changes to the superannuation rules in the foreseeable future.

In this submission we submit that the Government give ongoing consideration to how policy settings for superannuation and the age pension are integrated to ensure that efficient outcomes are delivered by the broader retirement income system. We believe that further consideration of this policy area is very much needed.

The SMSF Association also seeks action on Superannuation Guarantee (SG) reforms. We believe that a recommitment to the increase in the SG rate to 12 per cent should be legislated to ensure retirement savings for individuals are adequate. This should be supplemented by reforms which allow individuals to choose which superannuation fund they want to receive their SG contributions and to prevent unscrupulous employers from using loopholes to avoid paying their full SG entitlements.

We also focus on how SMSFs can be an important source of funding for domestic infrastructure, social impact investment and commercialising innovation. Accessing SMSF capital to fund these important areas would support economic growth and also deliver improved retirement income outcomes for SMSFs.

The SMSF Association also seeks increased transparency regarding the SMSF levy. We believe a review of the levy will ensure that SMSF trustee fees are used to regulate the sector in an efficient manner and for purposes which will improve the sector.

Additionally, our submission highlights significant red-tape issues impeding the superannuation system. The current restrictions facing SMSF members who reside outside of Australia and a host of technical amendments resulting from the introduction of the new super reforms on 1 July 2017 are problems that could easily be resolved by Government through improved legislation.

John Maroney
Chef Executive Officer
SMSF Association

TABLE OF CONTENTS

EXECUTIVE SUMMARY

BETTER INTEGRATION OF SUPERANNUATION AND SOCIAL SECURITY POLICY

The SMSF Association believes appropriate integration between the superannuation and social security elements of the retirement income system will help meet the needs of Australians through an efficient and sustainable retirement income system.

Accordingly, we recommend that the Government gives consideration to how the superannuation and age pension policy settings are integrated. We suggest that the Government considers shifting age pension means testing to a single comprehensive means test to ensure assets are fairly accounted for, to remove distortions based on how savings are held and to ensure that there are appropriate incentives to save and drawdown on savings in retirement. We believe legislating the objective of superannuation, and, incorporating the long-term savings to the Government from superannuation reducing age pension reliance in the Taxation Expenditures Statement will bring a much needed holistic approach to retirement income system policymaking.

SUPERANNUATION GUARANTEE AND CHOICE

The SMSF Association believes that the Government should recommit to increasing the Superannuation Guarantee rate to 12 per cent and do so with a faster timetable than currently legislated. Increasing the Superannuation Guarantee rate will help increase individuals' superannuation savings over the long term by ensuring that an adequate level of contributions is made. This is especially relevant for earlier stages of a person's life when superannuation contributions are not a priority and where individuals have broken work patterns. An increased SG will also improve Australia's savings gap and reduce our reliance on the aged pension.

We also advocate for measures which close loopholes allowing employers to reduce their employees' superannuation guarantee contributions unfairly to be legislated. This should be accompanied by giving employees free choice of superannuation fund for where their Superannuation Guarantee contributions are made. The SMSF Association believes the ability for all employees to receive the full Superannuation Guarantee contributions they are entitled to and choose their superannuation fund is an important element in promoting an efficient and competitive superannuation sector.

CONCESSIONAL CONTRIBUTIONS

The SMSF Association has concerns that the current concessional contribution of $25,000 per year for all individuals has negatively affected peoples' ability to save an adequate amount of superannuation to be self-sufficient in retirement. The higher cap for older workers recognised the fact that most people who are able to make voluntary contributions to superannuation do not do so until later in life when they have a greater financial capacity to do so.

We also believe that the $500,000 total superannuation balance limit on being able to make catch-up concessional contributions is too low and should be increased to $750,000 when the Government has fiscal capacity to do so. An increase in the limit would be a significant improvement towards creating opportunities for individuals, especially women, to build adequate retirement savings.

SMSF FUNDING INFRASTRUCTURE

The SMSF Association recommends that the Government and the Treasury work with industry to review and explore opportunities for infrastructure projects to be funded by SMSF capital. The superannuation sector plays an important role in funding infrastructure investment in Australia but the $701 billion SMSF sector is largely precluded from investing in and funding infrastructure. Additionally, allowing SMSFs to invest in infrastructure projects will deliver retirement income benefits for SMSFs that are seeking stable, long-term income to fund income streams and manage longevity risks.

SMSF LEVY

The SMSF Association seeks increased transparency regarding the current SMSF levy and its use as a cost-recovery mechanism for the Australian Taxation Office's (ATO) regulation of SMSFs. We believe greater transparency will ensure that SMSF trustee fees are used to regulate the sector in an efficient method and for purposes which will improve the sector.

SUPERANNUATION RED-TAPE ISSUES

The SMSF Association suggest the following key measures that the Government could take to remove red-tape and reduce the complexity of superannuation. These measures are:

1. Addressing inefficiencies in the current residency rules for Australian superannuation funds unfairly affecting SMSFs.
2. An amnesty to allow SMSF trustees to convert their term allocated and legacy pensions to account based pensions.
3. Amendments to allow reversionary transition to retirement income streams to be effective after the death of the original member.
4. Allowing a 12 month transfer balance cap credit deferral for receipt of a death benefit pension created by a binding death benefit nomination or SMSF trust deed clause.
5. Ensuring that disabled children are not unfairly impacted by the transfer balance cap limitations applying to child pensions.
6. Clarifying legislation regarding insurance proceeds and reversionary death benefit pensions.
7. Repealing the work test to harmonise contribution rules for older taxpayers with those under the age of 65.

BETTER INTEGRATION OF SUPERANNUATION AND SOCIAL SECURITY POLICY

The SMSF Association believes that a key facet of having an efficient and sustainable retirement income system which can meet the needs of Australians is to have appropriate integration between the superannuation and social security elements of the retirement income system.

We have major concerns that there is a lack of policy integration between superannuation policy and social security policy. A siloed approach to policy making in these areas has created policy settings in superannuation and social security that conflict and do not support each other to provide retirement income for Australians. They also result in perverse outcomes for many Australians in retirement, which we believe may be an unintended consequence from this siloed approach to. In many cases this can create significant disincentives for saving for retirement, which we believe would not be the Government's intention. A more coordinated retirement income policy approach is required to avoid these issues from occurring going forward and to address current weaknesses. We believe that the poor policy coordination between superannuation and social security is evidenced by:

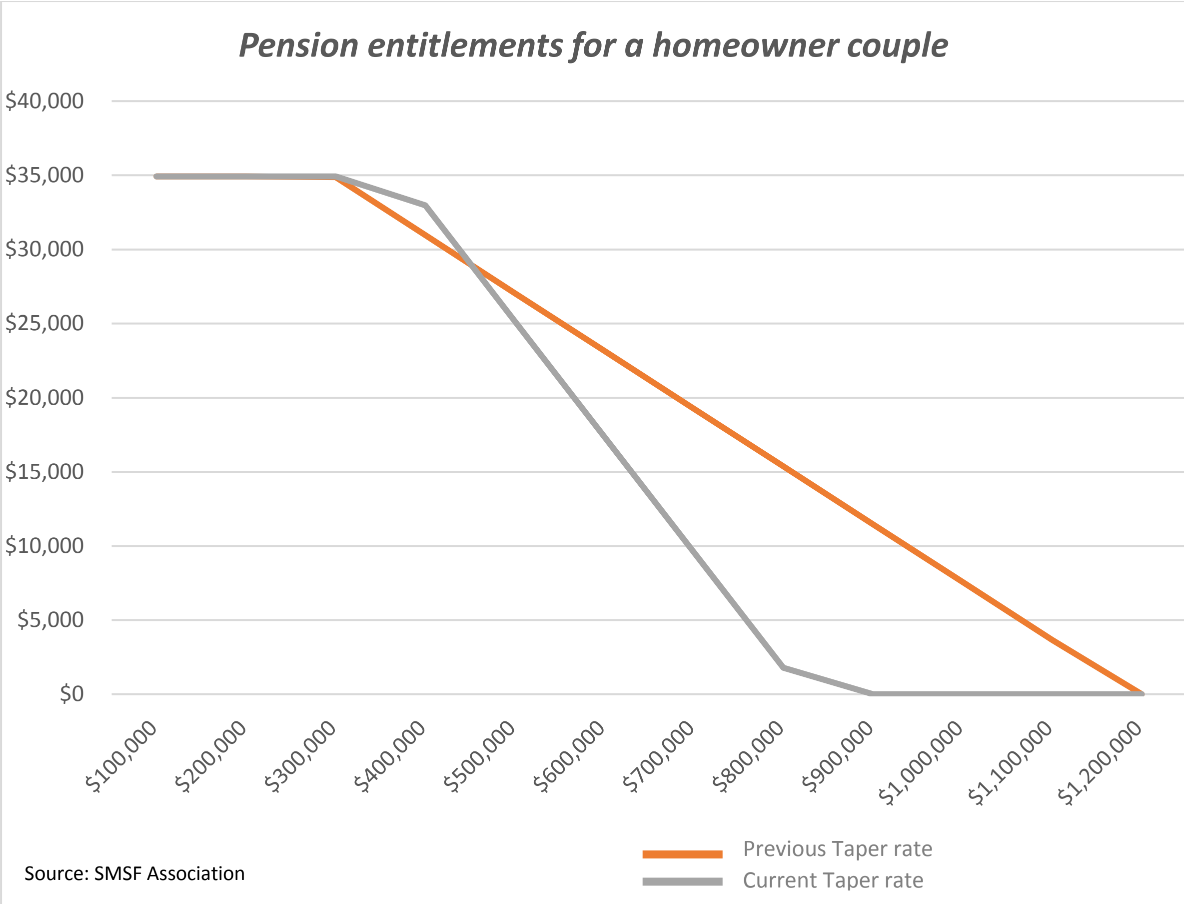
- Poor integration between the age pension and superannuation.
- Policies being implemented without consideration given to the Government's proposed objective of superannuation.
- A lack of clarity concerning costs and benefits of superannuation offsetting age pension costs.

On a larger scale, this lack of policy coordination is evidenced by the absence of a clear plan as to how Australia will address its aging population which requires a coordinated approach to policy covering retirement income, health, aged care, housing and many other policy areas.

AGE PENSION INTEGRATION WITH SUPERANNUATION

The policy settings of greatest concern to our Association are the recently implemented changes to the assets test rules for the age pension which took effect from 1 January 2017 reducing the entitlement to the age pension as a person's/couple's assets increase. We believe that the change to the means test taper rate and thresholds have had significantly adverse and presumably unintended consequences. While we support appropriately targeted mean testing to ensure the sustainability of the age pension, we have been concerned that this measure is not appropriately integrated with the broader retirement income system (i.e. superannuation and taxation settings) and discourages middle income earners to save for a self-sufficient retirement.

The changes to the taper rate for the age pension assets means test has a significant impact on middle income earners who have accumulated an average sized superannuation balance and benefit from a part-age pension payment which supplements their superannuation income. For home-owning couples that have a superannuation balance between $500,000 and $800,000, the increased taper rate creates a "black hole" where their assets above the asset test free amount causes them to be worse off in terms of income. This is caused by the taper rate of the equivalent of 7.8 per cent per annum reducing their pension entitlement at a rate in excess of the income they earn from their superannuation balance above the asset free area. This is especially an issue in a low interest rate and low investment return environment.



This creates an unfairly high effective marginal tax rate on superannuation assets that are in excess of the asset test free amount. This actively discourages middle income earners from saving for retirement and has other detrimental behaviour effects, such as providing an incentive to shift investments from assets that are included in the means test (e.g. superannuation) to those that are excluded (e.g. the family home). This is an example of how retirement income policy changes can have detrimental effects when they have not been appropriately evaluated or integrated with other policy settings.

Further, the use of both the assets test and an income test for means testing the pension, exacerbates distortions in decision making on how to hold retirement savings. The interactions of the two means tests with the tax system create complex outcomes for retirees who rely on a part age pension to supplement their superannuation income.

The difference between the preservation age for superannuation and the aged pension further exposes this ‘black hole’. The lack of alignment creates an incentive for individuals to drawdown on superannuation assets before relying on the age pension or ‘double dipping’.

The purpose of the superannuation and retirement income system is to fund retirement incomes, and the SMSF sector is doing this effectively with 94 per cent of retirement benefits taken in the form of an income stream.[1] Therefore any Government policy settings which conflict with this purpose need to be addressed to better achieve retirement income policy objectives.

Accordingly, we believe that a more appropriate and simpler mechanism to integrate superannuation and age pension means testing is to shift to a single means test that applies a deeming rate to financial and non-financial assets, removing the assets test. This would require a broader range of assets to be included in means testing and adjusting exemption thresholds and/or reducing exemptions from means testing to ensure fiscal sustainability. The Australia Future Tax System Review recommended that a single comprehensive means test should be pursued to ensure that assets are fairly accounted for, to remove distortions based on the form of savings and to ensure that appropriate incentives to save and use savings effectively remain.

A deeming rate can be adjusted to accommodate current economic conditions (e.g. the current low yield conditions confronting retirees) and can provide a far more suitable phase out rate than the assets test taper. This can avoid the "black hole" effect of the Government's proposed changes described above. In implementing a single deeming test, income test free levels and the treatment of certain exempt assets would need to be revisited.

While we understand the Government is facing fiscal constraints in making further changes to the retirement income system, we recommend that the Government reconsider age pension means testing in a broader context of retirement income settings to ensure that retirement income policy is delivering efficient and sustainable outcomes. We urge the need to consider such changes from a holistic system wide perspective as ad hoc changes to superannuation tax settings or age pension settings can undermine confidence in the retirement income system further deterring people from making the long-term savings decisions needed to save an adequate retirement income.

We recommend that the Government undertakes further work to assess how these important policy areas can be integrated to help deliver a better standing of living for people in retirement.

OBJECTIVE OF SUPER

The lack of a holistic policymaking approach to the retirement income system is also undermined by not having a legislated objective of superannuation. Legislating the current proposed objectives of superannuation 'to provide income in retirement to substitute or supplement the age pension' would provide guidance to support more holistic policymaking for retirement incomes across government. Accordingly, we encourage the Government to revisit the process of legislating the objective of superannuation in 2018.

The take-up rate of Australia's age pension is high. 70 per cent of retirees access some form of age pensions, with 60 per cent of recipients on a full age pension.[2] This is a symptom of most existing pensioners not having the full benefits of a career of compulsory super contributions. Therefore, to ensure future generations get the full benefit of being part of the superannuation system, retirement policy should also be supported by stronger legislation surrounding the objective of superannuation.

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[1] ATO, Self-managed superannuation funds: A statistical overview 2014-2015, Canberra, Commonwealth of Australia, 2016

[2] Treasury, 2015 Intergenerational Report, Canberra, Commonwealth of Australia, 2015.

Legislating an objective for superannuation should play a role in clarifying and distinguishing the roles of superannuation and the age pension. This would help remove the possibility that the objective of superannuation could be interpreted so that any income provided by superannuation above age pension level is a sign of overly generous tax concession support for superannuation. This should be done through legislating subsidiary objectives of superannuation which give appropriate context to a primary objective. Setting out these roles in the regulations or primary legislation will allow future Ministers to read them in conjunction with the primary objective.

We believe appropriate subsidiary objectives would include:

1. *Providing a secure and dignified retirement*
2. *Managing risks in retirement*
3. *Be invested in the best interest of members*
4. *Alleviate fiscal pressures on Government from the retirement income system*
5. *Equity*
6. *Maintain a pool of national savings*
7. *Be simple, efficient and provide safeguards.*

Including "*providing a secure and dignified retirement*" as a subsidiary objective supports the notion that superannuation fund members should be able to save to provide an income greater than the age pension to ensure they have a comfortable standard of living in retirement. This should also encourage self-sufficiency amongst people saving for retirement but does not herald open ended concessions for saving through superannuation.

We are aware of the Government's concern over the issues regarding including the concept of adequacy in the objectives of superannuation including not having an accepted defined value of 'adequate retirement savings' and that governments may feel pressured to apply adequacy to other policy areas, such as social security payments. We believe that these issues could be circumvented by including a subsidiary objective of "providing a secure and dignified retirement" as mentioned above rather than including adequacy as part of the primary objective.

We encourage the Government to consult with the superannuation industry and legislate the objectives of superannuation in 2018.

TAXATION EXPENDITURES STATEMENT AND THE LONG TERM COST OF SUPERANNUATION

The lack of coordinated policy integration between superannuation and social security policy is also illustrated by how the Taxation Expenditures Statement (TES) views the cost of superannuation tax concessions in a siloed manner. This is especially the case in regards to how the TES ignores how superannuation is reducing long-term age pension costs.

A substantial concern with the TES estimates for superannuation tax concessions is that the estimates do not account for the long-term savings that superannuation returns to the Government budget by reducing expenditure on aged support in the future. Given that reducing future dependence on Government welfare is a key objective of the superannuation system and a key policy rationale behind the tax concessions, it is inconceivable that our public policy measurements do not attempt to capture the value of the reduction of future Government expenditure created by superannuation tax concessions.

While we acknowledge that the TES exercise is aimed at reporting the magnitude of tax expenditures and not assessing policy rationales or how effective a policy is, we believe that this results in an inappropriate assessment of the "cost" of superannuation tax concessions. Excluding the future savings to Government expenditure on Age Pension results in a myopic and overly simplistic analysis of both the true costs of the superannuation tax concessions and the effectiveness of the superannuation system.

The TES measurements also do not take into account that superannuation balances would be lower if there was higher tax on superannuation contributions and earnings, resulting in an inconsistent long-term approach to estimating the tax expenditures. Lower superannuation balances would increase the future reliance on the Age Pension, placing greater pressure on Government expenditure in the long-run.

The need to incorporate long-term savings to the Government from superannuation in the measurement of superannuation tax concessions may mean that estimating the cost of the superannuation tax concessions should occur outside of the TES process in a standalone exercise. This would allow for a more fulsome assessment of the superannuation tax concession to occur, including the potential savings to Government in their costs. Otherwise, the TES could include alternative measurements of the superannuation tax concessions that include long-term savings to Government. This would provide an important alternative perspective to better inform policy debate.

The magnitude, future policy importance and controversy that often are generated by the TES costings of superannuation tax concessions justify the need to undertake alternative measurements for superannuation tax concessions.

We acknowledge that the Government has previously accepted Recommendation Four of the House of Representatives Standing Committee on Tax and Revenue Report on the Tax Expenditures Statement which sought to introduce a similar costing exercise to what we have described above. While we welcome this, we encourage the Government to expedite the introduction and implementation of this costing work so that a better understanding of superannuation and its long-term effects on government expenditure can begin to influence and contribute to policy debates regarding how superannuation policy should be developed.

SUPERANNUATION GUARANTEE AND CHOICE

The SMSF Association believes that the Government should recommit to increasing the Superannuation Guarantee (SG) rate to 12 per cent and potentially expedite this process, as well as improving SG compliance through sensible law changes.

INCREASE SG RATE TO 12 PER CENT

We believe the Government should recommit to increasing the SG rate from 9.5 per cent to 12 per cent and do so with a faster timetable than currently legislated. Under the current legislation the increase to 12 per cent is not legislated to occur until 2025. This is seven years later than the original policy to increase the SG rate to 12 per cent.

It is clear increasing the SG rate will help increase superannuation savings over the long term. For most people, saving for retirement through contributions to superannuation is not a priority in earlier stages of their life. Increasing the SG rate will assist people contributing enough to superannuation throughout their life to have adequate retirement savings. A higher SG rate, increasing from 9.5 per cent to 12 per cent will also assist those with broken work patterns to have higher superannuation balances when they retire.

Australia also currently has a large 'savings gap', the difference between the amount required to ensure an adequate retirement and the actual amount saved in retirement. As health care costs increase, the proportion of home owners fall and individuals live longer we expect this savings gap to increase further. An increase in the SG rate will close this gap, especially for younger demographics who will make up a large majority of the workforce as the nation ages.

An increased SG rate will also reduce the population's reliance on the aged pension. This further strengthens the ability for superannuation savings to meet the Government's chosen superannuation objective of substituting private savings for the aged pension. It also lowers the tax burden on an ageing population and benefits the economy. An increased superannuation pool also has the ability to benefit Australian businesses by allowing for a larger pool of domestic capital that can be accessed for investment.

We also note that during previous increases in the SG rate, that there was no detrimental impact on the economy. The gradual proposed increase should also ensure that real wage growth continues to occur for individuals at the same time as their superannuation retirement savings do.

Accordingly, we believe the Government should recommence increasing the SG rate two years ahead of schedule. We support the below timetable for the increase to the SG rate.

1 July 2019 – 10 per cent

1 July 2020 – 10.5 per cent

1 July 2021 – 11 per cent

1 July 2022 – 11.5 per cent

1 July 2023 – 12 per cent

We encourage the Government to consider this revised timeframe.

SUPERANNUATION GUARANTEE INTEGRITY

The SMSFA also believes it essential that measures that close a loophole used by some employers to reduce their employees' superannuation guarantee contributions when employees choose to make salary sacrifice contributions to superannuation be legislated. This would be of increased importance with an increase of the SG rate to 12 per cent.

Individuals who make salary sacrifice contributions intend for these contributions to be in excess of the mandated 9.5 per cent SG required to be paid by their employer. Legislation should exclude salary sacrifice contributions from satisfying an employer's superannuation guarantee obligations. We also support including salary sacrificed amounts in the base for calculating an employer's superannuation guarantee obligation. This will provide the correct result in determining an employee's superannuation guarantee entitlement.

These measures will ensure that taxpayers who use salary sacrifice to make additional concessional contributions to superannuation will be in the same position as taxpayers who make a personal contribution to superannuation and claim a tax deduction for their contribution. This is especially important now that the "10 per cent rule" which limited tax deductible personal contributions to taxpayers who earned less than 10 per cent of their income from being an employee has been repealed as of 1 July 2017. This means all taxpayers are now eligible to claim a deduction for personal contributions to superannuation, making the Government's proposed improvement of the SG even more relevant.

Ensuring employers are paying the correct superannuation is a key pillar of the superannuation system and is essential to ensure all Australians can reach a dignified and secure retirement and garner the full benefits of the superannuation system.

We acknowledge that these measures were previously included in the Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 2) Bill 2017, which that Government has deferred to after the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry reports. We strongly encourage the Government to advance these amendments separately to other legislation contained in that Bill.

Additionally, we support the Governments initiatives to continue to implement Single Touch Payroll and its 'superannuation guarantee integrity' package to ensure all employers are making correct and timely SG contributions.

CHOICE OF FUND

The SMSF Association has concerns where employees do not have a free choice of superannuation fund meaning they cannot choose where their SG contributions are made. We believe that constraining employee choice has negative effects of disengaging people from their superannuation, reducing competition and increasing superannuation account proliferation.

The SMSF Association believes the ability for all employees to choose their superannuation fund is an important element in promoting an efficient and competitive superannuation sector. In addition, all employees should be provided information about what choices they have in the superannuation sector available to them (e.g. industry fund, retail funds, SMSFs, etc.).

Being forced into a particular superannuation fund without choice not only affects younger, disengaged individuals but also older individuals transitioning to retirement that may already have an SMSF. A common scenario for SMSF members, of whom approximately 60 per cent are aged over 55, is working in part time jobs which can often fall under an enterprise agreement while transitioning to retirement. These people are restricted from having their SG contributions made into their SMSF and are instead required to have contributions made to the relevant default fund under the agreement. The SMSFA understands that there are many SMSF members affected by agreements that do not let them choose where their superannuation guarantee contributions go, including to their own SMSF.

Arrangements which do not give employers or employees any choice as to where superannuation contributions are made create a multitude of issues, the most significant being account proliferation and the consequent multiple set of fees and insurance premiums which continually erode superannuation balances.

Opening up choice of fund to all employees will also increase the efficiency of the superannuation system by removing the need of employees who are constrained by an enterprise agreement or other restriction to roll-over their contributions to their fund of choice. This is often the case for employees who do not have unconstrained choice of superannuation fund but wish to control their own superannuation through an SMSF. They receive contributions from their employer in their default fund and then periodically roll these amounts over to another superannuation fund of their choice. Undertaking annual or more frequent roll-overs of contributions made into a default fund to an SMSF constrains individual's investment choices throughout the relevant period, incurs unnecessary fees and reduces the efficiency of the system by requiring additional transactions.

For example, a 60-year-old individual may take up a part time job arrangement at a large retail company while they transition to retirement. They may already have an SMSF but under the retail company's enterprise agreement, they are not able to contribute directly to their SMSF. The current situation under the law forces the member to receive their SG contributions in the retail superannuation fund and then rollover these funds into their SMSF at later stages. With rollovers not currently administratively easy, this is a large compliance burden and financial burden. Furthermore, this member could be contributing small amounts of money to a defaulted superfund that could be consumed by fees before it is rolled over to an SMSF. This scenario is also known to occur in many industries such as universities, labour, transportation and retail, hence the positive impact of the draft legalisation should not be underestimated.

Reducing the effect of these problems as well as improving engagement through information and greater opportunity for choice will improve the efficiency and effectiveness of the superannuation system. Therefore, we believe enhanced choice and information are essential and crucial.

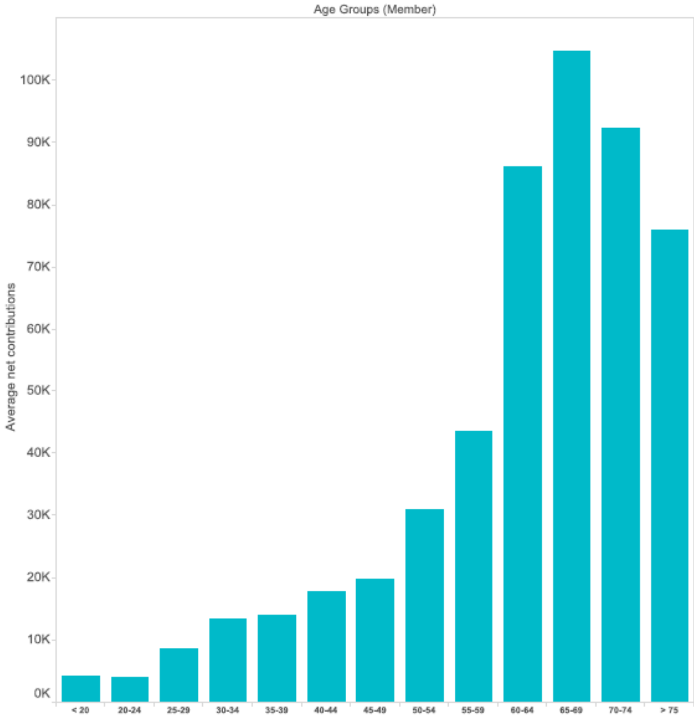
CONCESSIONAL CONTRIBUTIONS

$25,000 CONTRIBUTION CAP

The SMSF Association is concerned that the current concessional contribution cap of $25,000 per year for all individuals has negatively affected peoples' ability to save an adequate amount of superannuation to be self-sufficient in retirement.

Our main concern is the reduction in the concessional contribution cap for people aged 50 and over. The higher cap for older workers recognised the fact that most people who are able to make voluntary contributions to superannuation do not do so until later in life when they have a greater financial capacity to do so. Individuals traditionally make mortgage repayments, school fees and other immediate household expenses before considering the opportunity to build an adequate superannuation balance.

The fact that individuals wait until later in life to make greater financial contributions to superannuation is supported by research undertaken by Rice Warner on behalf of the SMSF Association analysing contribution patterns of SMSF members. The research shows a considerable increase in voluntary contributions by members who are in their-50s and onwards. This accords with the generally accepted idea that people will contribute more to superannuation later in life when they have increased financial resources to do so.



The research shows that voluntary contributions form the bulk of superannuation contributions from individuals approximately 55 years of age for both genders, and dwarf employer contributions in terms of average value after 60.

The significant impact that personal contributions can have on superannuation balances at retirement should not be underestimated. The restriction to $25,000 not only lowers retirement savings it forces individuals to consider other forms of tax effective retirement planning such as investment bonds or negatively geared property investment. When considered with the age pension 'black holes' mentioned earlier, the disconnect between superannuation and social security policy may force individuals to neglect superannuation contributions.

UNUSED CONCESSIONAL CAP CARRY FORWARD

The SMSF Association strongly supports the unused concessional cap carry forward measure and the increased flexibility that it brings to the superannuation. The measure is important because it allows the system to meet the needs of people with broken work patterns or volatile incomes. We believe the measure will significantly benefit women and assist them in making important catch up contributions to superannuation that can compensate for time out of the work force to raise children.

While we generally support the legalisation, we believe that the $500,000 total superannuation balance limit on being able to make catch-up contributions is too low and should be increased. Alternatively, in the interests of administrative efficiency the limit could also be removed entirely. We strongly believe that a $500,000 total superannuation balance does not represent an adequate amount of superannuation to fund a self-sufficient retirement.

Further, SMSF Association research produced by Rice Warner concluded that if the carry forward concessional contribution limit was increased from a balance of $500,000 to $750,000 it would benefit 13 per cent of the SMSF members sampled in the research, of which half would be female. This measure alone would be a significant improvement towards creating opportunities for women to build adequate retirement savings.

Accordingly, we believe that the Government should consider raising the total superannuation balance threshold to $750,000 when it has the fiscal capacity to do so.

SMSFS FUNDING INFRASTRUCTURE

Currently the superannuation sector plays an important role in funding infrastructure investment in Australia. Of the $2.3 trillion superannuation pool, large APRA-regulated super funds had $78 billion invested in Australian and overseas infrastructure at September 2017. Of this figure, two superannuation sectors, industry funds and public sector funds, dominate with $65 billion (83 per cent).

However, the SMSF sector is largely precluded from investing in and funding infrastructure.

The SMSF Association believes that SMSFs can have a substantial impact by providing capital funding for infrastructure investments and there is likely to be an increase in demand by SMSF investors for infrastructure assets if appropriate products are developed. Further, SMSF capital could be utilised for investments with positive social outcomes, such as affordable housing and social impact bonds.

ATTRACTIVENESS TO SMSFS

The SMSF Association believes that opening up infrastructure investments to SMSFs in a unitised, liquid form would provide a new avenue for SMSF investment that could help fund Australia's future infrastructure investment needs and also assist SMSFs in managing longevity risks in retirement.

The desire for control through direct investing and the desire to use alternatives to cash and term deposits by SMSF trustees will encourage investing in infrastructure as a long-term investment option. SMSF investors are also traditionally "sticky investors" that undertake investments with long-term investment time frames in mind. This makes SMSFs suitable for investing in infrastructure if the product is appropriately structured.

Infrastructure investments act as an important investment class that offers a risk-return point between cash/fixed interest and equity investments. This is attractive as younger demographics enter the SMSF space and a need for longer term investments arises due to increased life expectancies amongst the population. With SMSFs predicted to grow to asset holdings of $2.8 trillion by 2035[3], and currently around 25 per cent of SMSF assets held in low-risk assets (e.g. cash and fixed interest)[4], we expect the SMSF low risk capital pool to grow to approximately $730 billion by 2035. This large pool of low-risk preferred capital would be a viable and stable source of infrastructure funding in years to come.

BARRIERS TO ENTRY

Currently SMSFs are extremely limited in investing directly in infrastructure due to the high dollar threshold for infrastructure investment and the illiquid nature of the required investment. The SMSF Association believes that addressing these liquidity issues and removing administrative barriers will provide the most significant challenges in allowing SMSFs to have better opportunities to invest in infrastructure projects.

[3] Deloitte Actuaries and Consultants, "Dynamics of the Australian Superannuation System – The next 20 years: 2015-2035", 2015
[4] Australian Taxation Office, SMSF Quarterly Statistics – September 2017

Another factor restricting SMSF investment in infrastructure is the non-traditional and more complex nature of funding largescale investments from SMSFs. SMSF capital needs aggregation to fund large infrastructure projects which has led to their exclusion from infrastructure projects. This can lead to a bias of funding infrastructure projects from a consortium of large institutions with significant capital, depriving SMSF investors from exposure to infrastructure investments. We believe it would be of benefit for the Government and Infrastructure Australia to give consideration to how aggregation of SMSF capital could be facilitated.

For example, we believe a bond aggregator similar to the affordable housing bond aggregator would facilitate an aggregation of SMSF capital under its current model if it offered retail bonds. This framework would also be easily transitioned and applicable in its design for infrastructure projects.

A NEED FOR APPROPRIATE INVESTMENT PRODUCTS

Unitising investment in infrastructure projects in smaller parcels or lower value products for SMSFs (e.g. $25,000 units) would be one way to overcome current limitations, as would be issuing small-scale infrastructure bonds. Developing a secondary market in these products would allow SMSFs to manage liquidity risks, especially when they are in the retirement phase, so they can meet changing needs to realise their SMSF capital to generate income. Alternatively, Australian Stock Exchange listed infrastructure funds could provide SMSFs access to infrastructure, and infrastructure projects access to SMSF funds, plus address the liquidity issue.

NEW SOURCE OF INVESTMENT FUNDING

Opening up SMSF capital to infrastructure investments will allow capital to flow to projects that are currently unfunded due to the increasing need for infrastructure investment and the hesitance of large institutional investors to invest in smaller projects.

SMSF capital can play an important role in funding smaller infrastructure investments, such as local council infrastructure projects.

Also, SMSFs could form a reliable source of long-term debt funding that has not been available through traditional lenders for infrastructure projects. The long-term investment horizons of SMSFs matches well with the long-term nature of infrastructure investments, and SMSFs can play important role in providing longer-term debt financing that has been under-provided by Australian banks.

Accordingly, we believe there is a significant opportunity for SMSFs to fund infrastructure projects and provide capital to projects and financing that are not currently being funded.

We note that these discussions are also occurring with APRA-regulated superannuation funds. The recent business roundtable organised by Anthony Pratt and the Australian Financial Review and comments from the Treasurer stated the Government would welcome the superannuation industry and businesses supporting and creating new vehicles to encourage the availability of capital for business lending, especially to small business. SMSFs which form a large part of the superannuation industry should not be left out of this conversation.

RETIREMENT INCOME BENEFITS

Opening infrastructure investment to SMSFs would also have another benefit of offering SMSFs investments that can be used to fund income streams in retirement. SMSF trustees are looking to manage longevity risk by accessing long term investment options with low volatility, moderate yield relative to inflation and moderate capital growth. Infrastructure investments meet this profile. Allowing SMSF trustees greater access to investment types that allow them to generate stable income streams will allow them to self-manage longevity risk and generate retirement income.

COMMERCIALISING INNOVATION

Extending the concept of SMSFs funding infrastructure investment, SMSF capital also has the potential to be an important source of finance to fund the commercialisation of innovation. SMSFs are typically long-term and “sticky” investors and can prove the patient capital needed for innovation. Similar to infrastructure, the key barrier for SMSFs to funding commercialisation of innovation is the need for aggregation of capital so that they can access investment sizes that fit sensibly into their portfolio.

NEXT STEPS

The SMSF Association recommends that the Government and the Treasury work with industry to review and explore opportunities for infrastructure projects and commercialising innovation to be funded by SMSF capital. The SMSF Association is currently undertaking work with industry partners to develop options on how SMSFs can fund infrastructure and innovation and other social impact investments and would be pleased to bring these proposals to Government when complete.

SMSF LEVY

The SMSFA seeks:

- Increased transparency regarding the current SMSF supervisory levy.
- A review of the logic for the levy level in the context of greater transparency and consideration of greater SMSF involvement in SuperStream.

We believe greater transparency will ensure that SMSF trustee fees are used to regulate the sector with increasing efficiency, regulatory improvements, and an appropriate levy amount.

The SMSF levy has risen from $150 in 2009-10 to $259 in 2012-13, with no increases since then. This was a 73% increase in three years; and a 35.6% increase from 2011-12 to 2012-13.

A further significant change for people setting up an SMSF is that the levy is now collected in the income year in which it is assessed. This means that new SMSF have to pay two years' levy on set-up.

The increase and structure of the levy was based upon Government initiatives to improve regulation of SMSFs. These measures included SMSF bank verification, SMSF roll-overs being included as a 'designated service' under the Anti-Money Laundering and Counter Terrorism Financing Act 2006, and taxing super benefits received illegally at the top tax rate. These measures have not been proceeded with by the current Coalition Government as part of its strategy to reduce announced but unenacted tax and superannuation measures.

It is our view that at no stage has there been transparency as to the logic of the SMSF levy amount.

In 2013 at a Parliamentary Joint Committee (PJC)on Corporations and Financial Services Inquiry into the Superannuation Legislation Amendment (Reform of Self Managed Superannuation Funds Supervisory Levy Arrangements) Bill 2013, the ATO agreed to provide evidence for the most recent increase in the levy and why the cost-recovery process for SMSFs had increased, but the industry has not seen this evidence. The PJC noted in its final report:

> *The ATO has also advised that it will prepare and publish a cost recovery impact statement prior to the commencement of the levy increase on 1 July 2013. Nonetheless, provided that it would not cause an unreasonable diversion of the ATO's resources and that the information can be presented in a timely and meaningful way, the committee considers that the ATO should release information on a regular and publicly accessible basis about the costs that it incurs as a result of its SMSF regulation functions.*[5]

We believe the ATO should administer and implement this process as it is best placed to know and understand the costs involved, which we acknowledge should be appropriately paid by SMSF trustees through a levy.

The SMSFA firmly believes that the levy should reasonably reflect the ATO's costs in regulating SMSFs and as such, should be revenue neutral. Unfortunately, the industry has not been privy to information and transparency and have no sight of the cost-recovery process for SMSFs.

[5] https://www.aph.gov.au/~/media/wopapub/senate/committee/corporations_ctte/completed_inquiries/2010_13/selfmanagedsuper/report/report_pdf.ashx

The SMSFA is aware that the costs of administering the SMSF sector was approximately $85.2 million in 2011-12. The levy's last increase represented an additional $34.6 million in funding for the ATO. Given the increase in the number of SMSFs since 2012-13, we currently assess the SMSF levy to now generate approximately $155 million, almost double the last known funding costs. We understand the growth of the SMSF sector may cause challenges for the ATO and result in higher costs in monitoring and administering SMSFs, however, we would expect some scale benefits to accrue to the ATO as the SMSF population grows.

Other sectors that have cost-recovery mechanisms in place to fund their regulation have a greater level of transparency provided through a formal levy setting proceeds. For example, entities regulated by the Australian Prudential Regulatory Authority (APRA) and the Australian Securities and Investments Commission (ASIC) are provided with an annual levy setting process. While it may not be necessary to set the SMSF levy from year-to-year, we believe that this transparent levy process should be extended to SMSFs. This would bring greater transparency to the setting of the SMSF levy.

We therefore propose a cost-recovery statement be issued for the SMSF levy every three years. Much the same as APRA-regulated entities, the statement will be used to provide transparency as to how the SMSF levy is used to regulate the SMSF sector. This provides accountability and potential for the industry to efficiently utilise its funding.

Additionally, the ATO has indicated that SMSFs will be further integrated into the SuperStream system by implementing online rollover process and removing leftover manual processing in years to come.[6] This may require funding from the SMSF sector via the levy. Because of this it is important that the current levy is set an appropriate level so that any required future increases can be justified.

Accordingly, we encourage the Government to review the SMSF supervisory levy in the context of the above requested transparency and in the context of discussions as to greater SMSF involvement in SuperStream, as part of the 2018-19 Budget process.

[6] ATO, SuperStream Benefits Report, Canberra, Commonwealth of Australia, 2017.

SUPERANNUATION RED-TAPE ISSUES

Reducing red-tape in the superannuation system should be an ongoing focus for Government in order to maximise the efficiency of superannuation so that it can continue to deliver the best retirement income outcomes for fund members.

The SMSF Association suggest the following key measures that the Government could take to remove red-tape and reduce the complexity of superannuation. These measures are:

1. Addressing inefficiencies in the current residency rules for Australian superannuation funds unfairly affecting SMSFs.
2. An amnesty to allow SMSF trustees to convert their term allocated and legacy pensions to account based pensions.
3. Amendments to allow reversionary transition to retirement income streams to be effective after the death of the original member.
4. Allowing a 12 month transfer balance cap credit deferral for receipt of a death benefit pension created by a binding death benefit nomination or SMSF trust deed clause.
5. Ensuring that disabled children are not unfairly impacted by the transfer balance cap limitations applying to child pensions.
6. Clarifying legislation regarding insurance proceeds and reversionary death benefit pensions.
7. Repealing the work test to harmonise contribution rules for older taxpayers with those under the age of 65.

SUPERANNUATION RESIDENCY RULES AND SMSFS

Currently, the definition of 'Australian Superannuation Fund' in section 295-95 of the *Income Tax Assessment Act 1997* (ITAA 1997) creates administrative difficulties and red tape for members of SMSFs.

It involves situations where Australians who are temporarily resident overseas are prevented from making contributions to their SMSF due to the penalties involved and the fund being taxed as a non-complying superannuation fund. The alternative to not being able to make contributions to an SMSF is for the individual to make contributions to an APRA-regulated superannuation fund and on their return to Australia transfer those contributions back to their SMSF. This is cumbersome as it involves making contributions to a fund which is not the preference of the individual and causes significant additional costs to be incurred by having an extra superannuation fund and subsequently transferring the benefit to their SMSF. This increases both fund administration and compliance costs for the individual affected, reducing their superannuation balance.

The concept of an 'Australian Superannuation Fund' is central to the concessional taxation treatment of contributions, taxation of the fund and the payment of benefits. To satisfy the requirement that the fund is an 'Australian superannuation fund' there are three conditions that are all required to be met:

- The fund must be established in Australia, or any asset of the fund is situated in Australia during the year of income.

- The central management and control of the fund is ordinarily in Australia.
- The 'active member' test which relates to contributions made to the fund by non-resident active members for taxation purposes.

The first two conditions are an integral part of general taxation policy which requires an Australian resident entity to be taxed on income from all sources. In the case of a foreign resident, taxation is imposed on income that has an Australian source subject to double tax arrangements that may be in place. The central management and control of an entity, including a superannuation fund, is the basic premise on which residency is based. In the case of superannuation funds, principally impacting on SMSFs, there is an exception that applies if the fund's trustees are absent from Australia for up to two years and the legislation deems the central management and control to be in Australia during that period.

The third test is referred to as the active member test. This test is based on whether contributions have been made to the fund by someone who is a non-resident for taxation purposes. Under the rule, if a member of the fund is a non-resident and makes a contribution to the fund, the amount of their fund balance is used to measure whether the balances of all non-residents exceeds 50 per cent of the balances of all active members (those for whom contributions have been made). If the fund exceeds this 50 per cent test it will not meet the definition of an Australian superannuation fund.

Failure for a fund to meet the definition of an Australian superannuation fund means that it is treated as a non-complying fund. A complying superannuation fund that becomes a non-complying superannuation fund is taxed currently at 47 per cent on it is taxable income for the financial year and also taxed at 47 per cent on the value of the fund's investments at the commencement of the financial year in which it becomes non-complying, less the amount of any non-deductible contributions (non-concessional contributions).

The operation of these provisions impacts principally on SMSFs as well as small APRA funds as the breach of the active member test is in effect restricted to small funds. Larger APRA regulated retail and industry funds are not impacted as it would be extremely rare if not impossible to have the 50 per cent test breached. That is, it would be highly unlikely that more than 50 per cent of the value of members' assets who had contributions made to an APRA fund for them would relate to non-resident members for Australian taxation purposes. This is due to the scale and large membership size of APRA regulated funds.

SMSF trustees need to undertake increased costs to ensure they do not lose the status of being an Australian superannuation fund while the fund's members are overseas. As descried above, the alternative to contravening the active member test is for SMSF members to make contributions to a large public offer superannuation fund while overseas and then transferring those contributions to the taxpayer's SMSFs. This is inefficient, especially as transfers from APRA funds to SMSFs can be complex and slow, and increases compliance burden on SMSF trustees who may wish to work overseas for a period.

The history of the active member test was that the provision was originally inserted into *the Income Tax Assessment Act 1936* by *Taxation Laws Amendment Act (No. 4 of 1994)* as section 6E to provide a definition of a resident superannuation fund. The reason for the introduction of section 6E is stated in para 7.32 of Chapter 7 of the Explanatory Memorandum to the Bill:

Why is the new residency test for superannuation funds based on active members?

> *7.32 The test for residency of superannuation funds is based on active members to allow the trustee of a fund to control its residency status. The trustee can ensure a fund remains a resident by refusing to accept contributions that relate to non-resident members.*

It is not clear from the Explanatory Memorandum why the acceptance of contributions by the trustees of the fund allows control of the residency status of the fund for taxation purposes especially where an Australian resident moves overseas for work purposes. As a general rule under the income tax law, it is the establishment of the relevant entity and where its control and management reside that determines its residency for taxation purposes. The source of income received by the entity from transactions is not a determinant of its residency. For example, there are many entities, such as publicly listed companies and trusts who may receive the bulk of their income from overseas sources, however, that does not determine whether the company is a resident for Australian taxation purposes.

The introduction of section 295-95(2) into the ITAA 1997 from 1 July 2007 continued with the concept of the active member test. Unfortunately, the Explanatory Memorandum to *Tax Laws Amendment (Simplified Superannuation) Act 2007 (Act No. 181 of 2007)* does not provide any further guidance on the operation of the active member test.

We believe that the active member test does not provide additional integrity to the superannuation system as the establishment and central control and management test already ensure that only Australian based superannuation funds can benefit from the superannuation tax concessions. Instead, the active member test is an unnecessary source of red-tape, especially for SMSFs, adding costs and reducing the efficiency of the superannuation system.

PROPOSED SOLUTION: REMOVING THE ACTIVE MEMBER TEST

It is submitted that the 'active member' test should be excluded from the requirement for any superannuation fund to qualify for taxation concessions under the income tax law. Residency of the fund should be determined on the same principles as all other entities for income tax purposes, that is, the place of establishment and the location of the management and control of the entity.

Removing the active member test will ensure that SMSF members who are working overseas can still contribute to their fund where their SMSF balance exceeds 50 per cent of the fund's assets. This will mean that, as long as the fund was established in Australia and the central control and management remains in Australia, then an SMSF member can contribute to their fund of our choice.

PROPOSED SOLUTION: EXTENDING THE CENTRAL CONTROL AND MANAGEMENT EXCEPTION TO FIVE YEARS

Also, we suggest that the two year exception for the central control and management of a superannuation fund to be in Australia be extended to five-year exemption. The existing two-year exemption is too short in the context of modern work arrangements, where executive staff are often expected to commit to an overseas placement of greater than two years. Extending the central control and management exception will reduce red-tape and compliance issues for Australians working overseas while not compromising the integrity of the superannuation or taxation systems.

These proposed amendments will benefit SMSF members who spend time overseas working and wish to still make contributions to their SMSF to save for their retirement. We do not believe there will be any negatively affected superannuation fund members from the proposed amendments.

We believe that the proposed changes will have a negligible impact on revenue as the changes will cause concessionally taxed contributions to be redirected to an SMSF instead of an APRA-regulated fund, rather than creating an increase in concessionally taxed contributions.

These proposed amendments will remove a source of inefficient red-tape in the superannuation system helping SMSF members better save for retirement. It will also support the Government's policy to ensure that all superannuation fund members are able to exercise choice of where their contributions are made.

REVERSIONARY TRANSITION TO RETIREMENT INCOME STREAMS

ISSUE

Currently, there is an issue regarding reversionary transition to retirement income streams (TRIS) not automatically retaining retirement phase status for the beneficiary of the reversionary TRIS upon the death of the member receiving the original TRIS. The issue arises where the beneficiary has not met one of the four conditions of released prescribed in the legislation. These are:

- Attains age 65, or
- meets the retirement, terminal medical condition or permanent incapacity conditions of release and notifies the fund trustee of that fact.

The SMSF Association believes that a practical approach to dealing with the retirement phase status of revisionary TRIS can be implemented to avoid this.

Take for example a person who is 65 and in receipt of a TRIS that is in retirement phase. On the death of the member, the TRIS will automatically revert to the reversionary beneficiary who is 60. This beneficiary has not met any condition of release. Therefore, the legislation prescribes that the TRIS will now cease to be in retirement phase from the date of death.

This causes an issue with Regulation 6.21 of the *Superannuation Industry (Supervision) Regulations 1994* (SIS Regulations) which requires that a death benefit pension must be a pension in retirement phase. In addition, death benefits must be cashed as soon as possible and therefore the reversionary TRIS needs to be commuted and a new death benefit income stream commenced if the beneficiary wishes to continue receiving an income stream benefit. There is no leeway in the law to allow for a reversionary TRIS to exist where the beneficiary has not met a retirement phase condition of release.

The impact of this may cause the pension earnings tax exemption for the reversionary TRIS to cease. The beneficiary also loses the benefit of the 12-month credit for reversionary benefits for transfer balance cap (TBC) purposes (the effect of which can be seen in our passage below on 'Trust deed and binding death benefits and the transfer balance cap'). The process also increases the compliance and financial advice burden with the required documents needed to commute and recommence pensions. All these results are inconsistent with an ordinary account based pension (ABP), despite a TRIS in retirement phase effectively being an ABP. If the TRIS was an ordinary ABP the reversionary beneficiary would continue to benefit from tax exemption on pension earnings and the 12-month delay of a credit counting to the TBC despite the condition of release status of the beneficiary.

We have been alerted that this is Treasury's intent of the law but we believe this is inconsistent with the principles of reversionary pensions, especially when compared to ordinary ABPs which are in the same position as TRISs in retirement phase.

PROPOSED SOLUTION: EXPANDING THE CONDITIONS OF RELEASE

The SMSFA believes the law should be amended to include that being in receipt of a reversionary TRIS that was in retirement phase for the deceased as a condition of release, allowing the reversionary TRIS to be received by the reversionary beneficiary on an ongoing basis.

This would ensure that beneficiaries in receipt of a reversionary TRIS can continue to receive this death benefit income stream with the appropriate time to adjust their superannuation affairs. It gives beneficiaries 12 months before the pension is credited to their TBC, reduces documentation and compliance burdens and rightfully places these pensions into the same legal position as reversionary ABPs.

All beneficiaries of the new category of TRIS being in retirement phase will benefit from this amendment. This is crucial, given TRIS in retirement phase are a new income stream created out of the superannuation reforms which effectively mirror ABPs. We do not envision any losers from this amendment.

There may be some revenue loss in this amendment due to the fact reversionary death benefits continue garnering tax exemptions. We believe this amount to be inconsequential and do not believe that the current law is aimed at revenue protection.

TRUST DEED AND BINDING DEATH BENEFITS AND THE TRANSFER BALANCE CAP

ISSUE

The SMSF Association has concerns that the current legislation does not afford as 12 month TBC credit deferral for receipt of a death benefit pension facilitated by the governing rules of an SMSF or a binding death benefit nomination (BDBN).

Section 294-25 of the ITAA 97 allows reversionary beneficiaries of a superannuation pension to receive a 12-month delay for a credit to arise in their transfer balance account, giving the reversionary beneficiary sufficient time to adjust their superannuation affairs before consequences, such as breach of their TBC, take effect.

The governing rules of an SMSF trust deed or a BDBN can be used in estate planning to bind a trustee as to whom they pay a death benefit pension, and, how much and what type of benefit is to be paid. We believe that these estate planning methods effectively function the same as a reversionary pension nomination, yet do not receive the same 12-month deferral afforded to a reversionary pension. This results in using an SMSF trust deed or a BDBN in estate planning being penalised under the laws even though they effectively create the same result as a reversionary pension nomination.

For example, if a pensioner passes away on the 7 February 2018 with a reversionary pension to their spouse worth $1.6 million this will automatically revert to the spouse upon death. As there is a reversionary pension in place, the $1.6 million will not count towards the beneficiaries TBC until 12-months later on the 7 February 2019. The amount that is credited will be $1.6 million. The beneficiary has 12 months to arrange their affairs to ensure they will not breach the TBC (for example, they may roll back existing pensions to accumulation phase to retain the death benefit in superannuation).

If the same pensioner had created a BDBN that stated that upon their death their spouse would receive their remaining superannuation assets as a death benefit pension, the trustee has no discretion as to how they distribute this benefit. Although functioning the same as a reversionary pension, the beneficiary will have a credit immediately credited to their TBC for $1.6 million on the date of death. If the beneficiary had any positive amount in their TBC, they would be immediately liable for an excess TBC determination. They would also be forced to commute the portion of the death benefit pension that exceeds the TBC and pay it out of the superannuation system as a lump sum death benefit as death benefits must be cashed according to the SIS Regulations.

PROPOSED SOLUTION: ALLOW BDBNS AND TRUST DEED ESTATE PLANNING CLAUSES TO BE AFFORDED THE 12-MONTH DEFERRAL

We believe that the policy intent of the original amending legislation was to provide any trustee who cannot make a decision as to how a death benefit pension is paid, no matter how this is achieved, to be afforded the 12-month deferral for a TBC credit to arise.

Accordingly, we propose that binding death benefit nominations either by trust deed or death benefit nomination form which do not afford the trustee discretion how to pay a death benefit pension should also be awarded the 12-month deferral.

This would ensure that all taxpayers who receive a death benefit pension where their superannuation fund trustee had no discretion in paying the pension to receive a 12-month grace period to organise their superannuation and to maximise the advantages of receiving a death benefit pension.

This amendment would benefit all superannuation fund members who receive a death benefit pension from a deceased person, most often from a spouse or parent. We do not believe that there will be any losers from this recommended amendment.

We believe that this amendment would have a negligible impact on Government revenue.

DISABLED CHILDREN AND THE TRANSFER BALANCE CAP

ISSUE

Disabled children are currently subject to the TBC limitations that apply to child pensions. This is despite the fact that disabled children are treated separately under the child pension rules due to their circumstances. Once a child in receipt of a death benefit pension reaches age 25, the pension is generally required to be commuted and paid as a lump sum to the child, excluding children with a relevant disability. Children with a relevant disability are excluded from this condition due to the extenuating circumstances that means they may be unlikely to save for retirement themselves. The term 'disabled' is defined under the *Disability Services Act 1986*.

The TBC places limitations on the amount a disabled child can keep in a death benefit pension. When a child is a beneficiary of a death benefit pension, there will be circumstances where the child will have to share a TBC with a sibling and force them to accept amounts as lump sums.

For example, say a parent named Ryan passed away with a $4 million superannuation benefit in an accumulation account. Ryan has prepared BDBNs that his superannuation benefits be split equally between his two minor sons Tim (disabled) and Paul. Prior to 1 July 2017, each child would be eligible to commence a death benefit pension of $2 million. Upon turning 25, Paul would have commute his pension and receive the rest as a lump sum. Tim could continue his pension. From 1 July 2017, each child is only eligible to receive their share of the applicable TBC, being $800,000 each (50 per cent of $1.6 million). Therefore, the remaining $1.2 million must be payed to each child as a lump sum.

This is inconsistent with the intention behind child pensions to recipients with a disability. Disabled children need financial support indefinitely, especially with the loss of a parent. Under their health circumstances, disabled children may find it very hard to be able to support themselves financially and be financially independent. The TBC limitations restrict these individuals from being able to receive an income stream for the rest of their lives, which is essential for their wellbeing and forces them into accepting lump sums.

PROPOSED SOLUTION: CARVE OUT DISABLED CHILDREN FROM TBC LAWS

The SMSF Association believes the law should be amended to carve out children with disabilities from being subject to the TBC rules.

This would ensure that families and individuals that support disabled children will be able to financially plan and support these children as they age. A continual income stream for disabled children is essential for their standard of life.

This amendment would benefit all guardians and disabled children who are reliant on child pensions. We do not believe there are any negative outcomes to this amendment.

We believe that this amendment would have a negligible impact on Government revenue given the small number of disabled child pensions being paid.

INSURANCE PROCEEDS AND REVERSIONARY DEATH BENEFIT PENSIONS

ISSUE

The SMSF Association believes Government should also take the opportunity to clarify the position regarding insurance proceeds and reversionary death benefit pensions.

From 1 July 2017, receiving a reversionary death benefit pension, will cause a credit in the transfer balance account to arise 12 months after the date of death. The credit will be equal to the value of the reverted pension at the date of death. The 12-month delay allows for the dependent beneficiary enough time to ensure they can arrange their superannuation interests to not breach the TBC.

Currently it is unclear, whether insurance proceeds paid to a pension account after the date of death count towards the TBC either as

- part of the pension value, or
- as an additional credit when the proceeds are received, or,
- if they are ignored the same way as earnings on the pension assets are for the purpose of the TBC.

The relevant issue is whether insurance proceeds crystallise on death of the member or when the insurer confirms the claim.

PROPOSED SOLUTION: INSURANCE PROCEEDS SHOULD GIVE RISE TO ADDITIONAL TBC CREDIT WITH A 12 MONTH DEFERRAL

The SMSFA believes for simplicity and integrity that any insurance proceeds that are received by a fund and added to a death benefit pension should give rise to an additional TBC credit but with a 12-month delay from the date of receipt. This amendment should be made under the TBC rules in section 294-25.

This amendment will give members receiving a death benefit pension where insurance proceeds are added to the capital funding the pension time to manage their TBC in order to not cause an excess TBC determination.

The SMSF sector including trustees, financial advisors and regulators will benefit from the certainty of the amendment. Negative feedback may come from parts of the sector who believe that insurance proceeds should not count towards the TBC.

This amendment will increase revenue for the Government as insurance proceeds will count towards an individual's TBC and force greater sums of money into accumulation phase or out of the superannuation system.

AMNESTY TO CONVERT LEGACY PENSIONS TO ACCOUNT BASED PENSIONS

ISSUE

With the introduction of the TBC, we believe it is sensible to grant an amnesty period to allow SMSF trustees to convert their term allocated and legacy pensions to account based pensions. A superannuation 'clean up' is desirable for the Government, regulators and the superannuation industry for the purposes of simplicity and efficiency.

Legacy and term allocated pensions include:

- Life-time pensions and annuities.
- Market-linked pensions and annuities.
- Life expectancy pensions and annuities.

These pensions, which were set up prior to 1 January 2006, are generally closed or no longer offered to new members in retirement phase but members who are already in receipt of one are still entitled to them. They were developed after the introduction of the reasonable benefits limit scheme in order for trustees to maximise their retirement savings.

Term allocated and legacy pensions now exist in an environment where they have little relevance and one where many SMSF trustees currently do not fully comprehend their operation and the impact the TBC has on them. This is because they have not been able to be established in over a decade. They are difficult to account, explain and advise upon.

Their relevance in the superannuation industry is further diminished by the significant regulatory changes to superannuation laws. The introduction of the TBC results in some of the most complex laws and outcomes in financial services for these pensions.

For example, modifications in section 294-125 of the ITAA 1997 allows individuals to determine a 'special value' of a capped defined benefit income stream. For individuals receiving a life-time pension or annuity, their special value is their first pension payment, annualised and then multiplied by 16. This special value amount is only used for the purposes of the individuals transfer balance account.

This special value does not generally reflect the actual value of the underlying superannuation assets supporting the pension. For some market-linked pensions there is the opportunity post 1 July 2017 to be commuted and restarted with the capital value of the assets supporting the pension replacing the special value as the amount counted towards the TBC. This strategy is facilitated by the different valuation rules for market-linked pensions commenced before and after 30 June 2017. This strategy adds further complexity to these pensions and creates more adverse results depending on the commutation special value.

The recent reforms introduce further complex concepts such as 'capped defined benefit balance' and a 'defined benefit income cap' just to accommodate these legacy pensions to be measured under the TBC which was designed for account based pensions. These pensions are difficult to administrate and harder to report. They are further complicated when an individual has an account based pension at the same time.

The recent superannuation reforms are failing at accommodating and integrating legacy pensions made under old superannuation laws with complex new laws.

PROPOSED SOLUTION: AMNESTY PERIOD THAT ALLOWS CONVERSION TO ACCOUNT BASED PENSIONS

We believe a transitional period that allows for trustees to commute and recommence these pensions as account based pensions with the value of the assets which underlie the pension counting to their TBC as common sense. An amnesty to 'flush out' legacy pensions would also give the opportunity for individuals to take up new more innovative retirement income products rather than being locked into legacy products. This is another significant benefit which will allow individuals with legacy pensions to better drawdown on their savings and address longevity risk.

A transition period would remove the restriction and penalties around the commutations of these pensions. This would include allocating the reserve accounts that are consistent with these pensions to capital supporting an account based pension, resolving current uncertainty of how reserves interact with the TBC. Furthermore, any commutation could only be conducted to incorporate a 100 per cent move to an account-based pension account. This would assist in providing a simpler superannuation landscape for the future.

REMOVING THE WORK TEST

ISSUE

The SMSF Association believes the Government should consider restoring its previous policy announced in the 2016-17 Budget to repeal the superannuation work test.

This measure would have harmonised the contribution rules for older taxpayers with those applicable to taxpayers under the age of 65. This would have reduced complexity in the superannuation laws and improved flexibility in the system. The SMSFA was very supportive of this policy.

Given the changes in workforce participation and changes to the age pension, the removal of the work test would have removed barriers and the red tape associated with superannuation contributions made by older workers. SMSF auditors and professionals find that confirming if an individual over 65 has worked 40 hours in 30 days as an arduous process, creating unneeded inefficiency. Additionally, this inefficiency corresponds to a rule which is difficult for the ATO to police.

As stated earlier, the ability for individuals to increase their contributions comes later in life when they are more financially capable to do so. The work test unfairly penalises individuals in this situation where they either are still working but have not met the required hours or have a potential windfall gain through other means (for example, an inheritance).

As the concessional contribution cap is now lowered to $25,000 for individuals, the work test can restrict people from opportunities after the age of 65 to make catch up contributions to superannuation. Individuals with low superannuation balances may also not be able to utilise the catch up concessional contribution measures because of the work test. The catch up measures were intended to benefit these individuals who have had broken work patterns and low balances to provide them with adequate retirement savings. Individuals who are restricted by the work test also fail to realise the benefits of the ten per cent rule being repealed.

PROPOSED SOLUTION: REPEAL THE WORK TEST

The SMSF Association proposes the work test be repealed. This will give access to individuals to making contributions to allow them to build adequate retirement savings. Furthermore, it reduces red tape the and a compliance provision which is easily worked around and difficult to police.

Alternatively, we suggest that consideration be given to including volunteering as a potential category that satisfies the definition of ‘gainfully employed’. This provides a strong social outcome and encourages individuals give back to society. This measure would also provide more flexibility for individuals aged 65 to 74, who may not be able to find gainful employment.