SMSF Association Supplementary Budget Submission 2020-2021

Prioritising red tape reduction

We are here to improve the quality of advisors, the knowledge of trustees and the credibility and health of a vibrant SMSF community.

ABOUT THE SMSF ASSOCIATION

The SMSF Association is the peak body representing the self-managed superannuation fund (SMSF) sector which is comprised of 1.1 million SMSF members and a diverse range of financial professionals servicing SMSFs. The SMSF Association continues to build integrity through professional and education standards for advisers and education standards for trustees. The SMSF Association consists of professional members, principally accountants, auditors, lawyers, financial advisers and other professionals such as tax professionals and actuaries. Additionally, the SMSF Association represents SMSF trustee members and provides 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 – PRIORITISING RED TAPE REDUCTION

The SMSF Association welcomes the opportunity to provide a supplementary Budget submission. This submission should be read in conjunction with our previous submission. In this supplementary submission, we focus on red tape and prioritise a number of policy positions to reflect a post COVID-19 environment requiring deregulation.

We support the Federal Government's stated ambition to grow the Australian economy out of debt in the wake of the COVID-19 induced recession – and cutting the red tape that is stifling the financial advice sector for consumers and advisers should be integral to this goal.

With the Government's intention to stimulate growth, we believe simplifying the regulatory framework around the financial advice industry can play an important role in this process.

Therefore, in this supplementary submission we highlight improvements to the regulatory framework for financial advice, red tape reduction options and refinements to the operation of superannuation legislation. We believe it is imperative for the Government to commit to a review of the financial advice framework so more consumers can seek affordable advice as the economy improves and so unmet SMSF advice needs can be met.

In addition, we believe financial advisers should have the ability to access superannuation tax portals of their clients as they continue to advise on the complexity of superannuation to consumers.

The SMSF Association also continues to prioritise red tape reduction and legislative improvements including transitioning of legacy pensions, repealing the work test, streamlining superannuation cap thresholds, improving spousal equalisation measures, fixing SMSF residency rules and providing a practical approach to non-geared unit trust investment breaches for SMSFs.

Reducing the amount of red tape in the superannuation and financial advice sectors will no doubt improve efficiencies and reduce costs for all participants. It is clear that the superannuation sector will play a crucial role in helping many Australians and businesses recover from this economic crisis.

The Retirement Income Review and its intriguing intersection with an economic recession triggered by a global pandemic will also provide significant input to superannuation policy discussions. Once the Retirement Income Review has been released, greater structural and system wide changes may need to be considered. The SMSF Association is ready to engage in these policy discussions upon release of the Retirement Income Review.

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COMMIT TO A REVIEW OF THE FINANCIAL ADVICE FRAMEWORK TO ENSURE CONSUMERS ARE PUT FIRST AND UNMET SMSF ADVICE NEEDS ARE MET

The SMSF Association (SMSFA) believes that there are impediments in the current regulatory advice model which prevent SMSF trustees from obtaining the SMSF advice they require. For example, an unlicensed tax agent cannot recommend that their client dispose of an interest in an SMSF even when it is clearly inappropriate for their circumstances.

The issue to be resolved concerns how SMSF and superannuation advice and services fit into the financial advice regulatory framework for both accountants and financial advisers. Essentially, the outcome should improve consumer protection, ensure unscrupulous advice is prohibited and ensure consumers are able to receive SMSF advice efficiently.

Since 1 July 2016, accountants and other advisers must be licensed or authorised with the Australian Securities and Investments Commission (ASIC) either through a full Australian Financial Service Licence (AFSL) or limited AFSL to provide SMSF advice services. Operating via an exemption, Tax Practitioners Board (TPB) tax agents (recognised accountants) were typically the main source of advice for SMSF trustees prior to this. However, the take up of the limited licence regime has been underwhelming.

Currently, SMSF trustees who wish to seek SMSF advice are either required to seek formal costly financial advice from a licensed financial adviser or must act without advice. This means there are important unmet SMSF advice needs in the market.

Furthermore, the overarching regulatory framework which regulates professionals who deal with SMSFs and superannuation is complicated, inefficient and the law is uncertain and is able to be worked around.

The desired policy outcomes from introducing limited licensing have not been achieved. Individuals have unmet financial advice needs, financial advisers face high regulatory costs and burden and both accountants and financial advisers are strangled by regulation.

The SMSFA is working in conjunction with the Financial Planning Association, Chartered Accountants Australia and New Zealand, CPA Australia, and the Institute of Public Accountants to propose a new consumer-centric financial advice framework and we outline how SMSF and superannuation advice can be improved in this project. This is because it has become increasingly difficult for many Australians to create a financial plan, set financial goals and achieve financial security in a rapidly changing environment. The cost of accessing advice has significantly risen to a point that has never been higher. In addition, many consumers believe their financial circumstances and assets may not warrant seeking advice.

The SMSF Association believes that:

1. The limited licence framework has failed and hence should be removed and transitioned to a new consumer-centric framework. This is because:

    a. The exemptions and legal obligations from the limited licence framework are complex

    b. FASEA ignored the limited licence framework

c. Poor take up of limited licences

d. Execution only service is occurring frequently

e. The framework prevents SMSF trustees from obtaining the SMSF advice they require in a convenient and affordable manner (such as winding up an SMSF).

2. There is an opportunity to rectify the current regulatory burden which exists in SMSF and superannuation advice, raise SMSF advice standards as per the Productivity Commission recommendation and reduce the advice gap.

   a. The economic impacts of COVID-19 have highlighted the strains resulting from the system's costs and inefficiencies. The recovery period and policies now provide a further opportunity to rethink and design the professional advice framework. This includes the provision of 'strategic advice' which is decoupled from products and 'scaled advice' which could allow broader access to advice for consumers regarding how to structure their financial affairs, particularly relating to superannuation.

   b. Advisers who provide advice to individuals about SMSFs should have specific SMSF education and qualifications that underpin their advice.

There is a clear need to take action to address this important objective and to help restore the community's trust and accessibility of advice to improve their financial well-being.

This needs to be conducted by removing the need for multiple licences, registrations, regulators and associated levies to reduce the costs of providing strategic financial advice. In addition, improving an individual adviser's accountability for their own conduct and behaviour, while removing some of the barriers and current challenges around licensing under an AFSL, should be pursued.

Regulation therefore should be simplified so that its intent is clear, and the regulatory framework should be streamlined to improve the effectiveness of regulators and ensure consumers have confidence that their rights are being protected and their individual needs are the first priority for all advice matters.

We believe a revised regulatory framework should comprise:

- Individual registration of advisers with a single body
- Single education framework for individual advisers – replacing the current separate education standards for financial advisers set by FASEA and tax (financial) advisers set by the TPB
- A harmonised Code of Ethics to provide a single statutory code for professional advisers
- Appropriate consumer protection, including access to dispute resolution
- Appropriate compliance obligations and costs

When seeking advice on a particular aspect of their financial situation, consumers often find that advice can only be provided in an "all or nothing" fashion. This is because the advice framework is designed upon the provision of specific financial product advice. For example, consider a consumer seeking simple advice on whether they should take money out of their super under the COVID-19 relief measures prior to temporary relief being implemented. A licensed adviser is required to comply with a number of obligations, including considering the client's entire financial position and objectives (including future unknowns), preparing a statement of advice, that can take weeks and cost thousands – when ultimately the client wants to know how to pay their bills and keep a roof over their head. The ability for professionals to provide specific single-issue advice or 'scaled advice' is extremely limited. FASEA standards have further made the provision of 'limited' or 'scaled' advice almost impossible to provide.

Notably, these issues continue to occur around superannuation advice. The complex limited licence framework for SMSF accountants and advisers, the carve out for intra-fund advice for superannuation trustees and the lack of clarity around scaled advice for fully licensed advisers are all evidence of this problem. We believe that providing a new overarching framework for superannuation advice is key to improving this process.

The regulation of financial advice should also be decoupled from recommendations of financial products, reflecting a history in which a product recommendation was the core component of most financial advice. In a professional financial advice sector, this is no longer the case.

A strategic advice model allowing suitably qualified professionals to practise under a 'no product recommendation' environment would see advisers given increased ability to provide strategic advice without conflicts of interest. It would also address the false perception that financial advice is simply 'selling products' and in time would help to address the issue of trust in the sector.

Appropriately qualified advisers would be able to choose specific areas of advice and specialisations which are either strategic only, product only, or both. This would create an efficient regulatory system for the provision of strategic advice, while helping to restore community trust and confidence by separating the provision of advice from the sale of a financial product.

The delay in implementing Royal Commission recommendations, particularly the establishment of a single disciplinary body, provides further time to consider and implement a new model.

PROVIDE FINANCIAL ADVISERS ACCESS TO SUPERANNUATION TAX PORTALS

Currently, only registered tax agents (typically accountants) are able to access the Australian Tax Office (ATO) portal to obtain total superannuation balance (TSB) and transfer balance cap (TBC) information which is crucial for SMSF advice. Ironically, these advisers are generally not able to provide SMSF advice as they are not licensed or authorised with ASIC. Incongruously, those licensed advisers who have the ability to provide SMSF advice (such as a financial adviser) have no reasonable way of sourcing ATO portal information directly from the ATO as they are not, generally, the member's personal tax agent.

In essence, there is a fundamental lack of information for SMSF advisers who need to provide timely advice based on myriad of complex caps, thresholds and balances. Accountants are able to obtain information but cannot provide advice and financial advisers are unable to obtain information but are the advisers authorised to provide advice. This jeopardises the quality and efficiency of advice that is being provided to members.

Even advisers who are registered with the TPB as a tax (financial) adviser are restricted from this access.

Without direct access to this information, SMSF advisers and administrators must rely on clients accessing the information through their MyGov account, downloading the information and then sending it to their adviser. Some advisers have been forced to send in written requests signed by the taxpayer and wait upwards of six weeks for a written reply. This is hardly conducive to giving timely and affordable SMSF advice.

This problem has been acknowledged by the ATO Deputy Commissioner James O'Halloran[1]. He noted it was a frustrating aspect of professionals dealing with TBC reporting or excess TBC determinations.

For example, advisers are unable to see the information the ATO has relied on when determining their client has exceeded their TBC.

SMSF administrators and software providers are also locked out of this data and do not have efficient ways of accessing it. The majority of SMSFs are administered with the assistance of purpose-built software. If these providers could access relevant ATO application programming interfaces (APIs) (subject to privacy protection and formal authorisations) for all client members, it would provide the only source of officially consolidated member information across all superannuation funds available. This vital information would enable SMSF service providers to protect the integrity of the superannuation system in general, and the SMSF sector in particular, by minimising the potential for errors in both reporting and action.

In addition, over time a client's personal TBC may differ from the general TBC due to proportional indexation. This will be a complex situation which will result in every superannuation member in the retirement phase essentially having their own personal TBC which is different to the standard TBC.

If an individual's personal financial tax adviser is unable to provide them with timely and efficient advice because of restricted access, this will add further complexity to the system.

[1] https://www.smsfadviser.com/news/16956-ato-makes-moves-to-fix-unworkable-tbc-data-access

Proposed solution: Provide SMSF advisers and administrators access to ATO portals

We understand that this may incur a cost for the ATO and require more resources to implement.

However, we believe it is imperative that access is opened to SMSF advisers. We recommend individuals who are registered with the TPB as a tax (financial) adviser and the fund's appointed SMSF administrator should be provided access to ATO portals for the purposes of SMSF advice on an individual and group level.

The level of complexity, some of which has been highlighted in this submission, means that the ATO, should be resourced to provide efficient forms of information to all authorised advisers.

We encourage the Government to make this an ATO priority project.

TOTAL SUPERANNUATION BALANCE THRESHOLD COMPLEXITY

Introduced on 1 July 2017, an individual's total superannuation balance (TSB) is used to determine an individual's ability to access certain superannuation taxation incentives. The SMSF Association has been supportive of this measure as an effective way to target those taxation incentives to appropriate cohorts of superannuation members.

However, the introduction of multiple TSB thresholds is unnecessarily adding to the complexity of the superannuation system. This has made it very challenging for individuals to understand the superannuation system.

Currently, the following different TSB thresholds apply:

- $300,000 TSB for work-test exemption contributions.
- $500,000 TSB for catch-up contributions.
- $1,000,000 TSB threshold for quarterly TBC reporting.
- $1.4 million, $1.5 million and $1.6 million bring forward non-concessional contribution caps.
- $1.6 million TSB threshold for non-concessional, spousal, and co-contributions.
- $1.6 million TSB threshold for segregated pension assets.

Some of these thresholds are indexed and some are not. The indexing methods also vary. This all leads to great complexity and increase in costs. Not only do clients find this confusing, but many advisers do as well.

These thresholds have not only added complexity to trustees trying to understand and use the superannuation system but also for their advisers and administrators to administer. It also increases the professional services fees paid by superannuation members as they need specialised advice to understand the multiple different thresholds that may apply to them and when they apply.

Furthermore, it can lead to unintended errors being made by members which, in the main, are administratively difficult to resolve and often involve substantial penalties. Seeking to rectify errors within the system typically proves a costly and lengthy process.

Proposed solution: Streamline TSB thresholds

The SMSF Association proposes the following amendments which would help streamline and simplify the use of the TSB:

1. Increase the work-test exemption TSB threshold to $500,000 to align with the catch-up contribution's threshold
    a. This would reduce the number of thresholds and provide a single TSB for alternative contribution measures. Given the applicability of the work-test exemption we do not believe this would cause a significant revenue cost to the Government.
2. Phase out the $1 million quarterly TSB threshold within two to three years
    a. This would further reduce the number of TSB thresholds and increase the amount of quarterly reporting to SMSF trustees and the ATO in a timeframe when the majority of SMSFs should be able to undertake this process.
3. Remove the $1.4 million and $1.5 million TSB bring forward non-concessional contribution (NCC) thresholds.

a. This would reduce the complexity involved in making bring forward NCCs when nearing the $1.6 million TSB threshold. We believe a simpler superannuation system would allow all individuals who are under 65 and under $1.6 million the ability to make the full $300,000 bring forward NCC. This reduces the ability for confusion and complexity in the system and also allows individuals to increase their superannuation and better provide for their retirement. We do not anticipate that this would cause a significant revenue cost to the Government as individuals are only able to make use of the bring forward rule once every three years.

b. This would also result in the use of one single $1.6 million threshold for NCCs, spousal and co-contributions which aligns with the segregated pension threshold and the general TBC.

SUPERANNUATION RESIDENCY RULES AND SMSFS

Currently, the definition of 'Australian Superannuation Fund' in section 295-95 of the ITAA 1997 creates administrative difficulties and red tape for members of SMSFs. This issue also equally applies to small APRA funds.

It involves situations where Australians who are temporary residents overseas are being prevented from making contributions to their SMSF due to the penalties involved and the fund potentially 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 a large APRA-regulated superannuation fund and on their return to Australia rollover 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 fund administration and compliance costs for the individual affected, reducing their superannuation balance, which is something the Productivity Commission has highlighted as a concern.

The fact that the residency rules unfairly affect superannuation members who 'choose' to save for retirement in an SMSF but do not affect those who save in a large APRA- regulated superannuation is inequitable.

The concept of an 'Australian Superannuation Fund' is central to the concessional taxation treatment of contributions, the 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 temporarily absent from Australia for up to two years during which period the legislation deems the central management and control to be in Australia.

The third test is referred to as the active member test. This test is based on whether a fund member is a contributor and is a non-resident for taxation purposes. Under this 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 45 per cent on it is taxable income for the financial year and also taxed at 45 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 broadly any non-deductible contributions (non-concessional contributions).

It should also be noted that the existing definition of Australian superannuation fund existed prior to the requirement to hold a tax file number in order to be eligible to make non-concessional contributions and before the introduction of the non-concessional contributions cap. These measures reduce the likelihood of providing tax concessions to people who have not paid tax in Australia. Also, the ability to make concessional contributions is either tied to superannuation guarantee obligations of Australian taxpaying employers or requires an individual to have taxable income in Australia.

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.

Generally, 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.

It should be noted that a contribution or rollover as small as one dollar could result in a fund failing the active member test, which sometimes can come from an unrelated third party such as an employer or the ATO. In this case the ATO has no discretion and would be forced to make the fund non-complying. An inadvertent mistake or delayed rollover can result in regulatory action with significant tax liabilities applying that could substantially reduce a person's ability to self-fund retirement, contrary to the policy objectives of superannuation.

We believe that the active member test does not provide any additional integrity to the superannuation system as the establishment and central control and management tests 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 and small APRA funds, adding costs and reducing the efficiency of the superannuation system.

Confusion and complications relating to the active member test is also one of the most popular topic areas for technical questions received from advice professionals through the SMSF Association's Technical Research Service.

Proposed solution: Removing the active member test and provide ATO discretion

It is submitted that the 'active member' test should be removed 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 would ensure that SMSF members who are working overseas can still contribute to their fund where their fund balance exceeds 50 per cent of the fund's assets. This would mean that, as long as the fund was established in Australia and the central control and management ordinarily remains in Australia, then an SMSF member can continue to contribute to a fund of their choice.

Proposed solution: Extend the temporary absent exception for the central management and control test from two to five years

We suggest that the two-year temporary absence exception for the central management and control of a superannuation fund to be in Australia should be extended to a five-year exemption. The existing two-year exemption is too short in the context of modern work arrangements, where executive and other staff are often expected to commit to an overseas placement of greater than two years. Often, what initially starts out as a one or two year overseas assignment also gets extended for greater than the initial period. 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 fund to save for their retirement. We do not believe there will be any negatively affected superannuation fund members from the proposed amendments.

In fact, in light of COVID-19 the ATO issued temporary relief if the individual trustees of an SMSF or directors of its corporate trustee are stranded overseas. This has been a successful introduction of a more practical application of SMSF residency rules that has not resulted in negative outcomes.

We believe that these proposed changes would have a negligible impact on revenue as the changes would simply cause concessionally taxed contributions to be redirected to an SMSF instead of a large APRA-regulated fund. In other words, it would simply result in a re-direction of contributions rather than creating an increase in concessionally taxed contributions.

These proposed amendments would remove a source of inefficient red tape in the superannuation system helping SMSF members better save for retirement. It would also support the Government's policy to ensure that all superannuation fund members are able to exercise choice of where their contributions are made. Further, it is consistent with removing the inefficiencies that exist as a result of members having multiple superannuation accounts.

REPEAL THE WORK TEST

The SMSF Association believes the Government should consider restoring its previous policy announced in the 2016-17 Budget to repeal the superannuation work test. However, for integrity purposes, we believe the work test should only be removed for non-concessional contributions.

This measure would have harmonised the contribution rules for older taxpayers with those applicable to taxpayers under the age of 67 and would have reduced complexity in the superannuation laws and improved flexibility in the system.

The introduction of the $1.6 million TBC and the prohibition on non-concessional contributions for individuals with balances over this limit is already an effective measure of restricting contributions. A modern superannuation system should not involve further age complexity and tests when the current thresholds provide a numerical prohibition on contributions.

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 can be an arduous process, creating unnecessary inefficiency.

Additionally, this inefficiency corresponds to a rule which is difficult for the ATO to police. This means individuals are also able to easily manipulate the work test to ‘satisfy’ the conditions without much rigour.

The work test is also no longer relevant to the modern super system, especially as superannuation should be universal and not discriminatory. Removal of the work test may result in an increase in female participation or an increase in the average female’s account balance. This will also especially be important moving forward with the limited opportunities available for people to obtain gainful employment.

This difficulty has been highlighted by members, where older individuals are unable to contribute to superannuation because they are no longer working the required hours since the impact of COVID-19. Individuals on JobKeeper are affected similarly.

In addition, the work test has effectively been replaced with the implementation of the TSB threshold which restricts non-concessional contributions when individuals have a balance above $1.6 million. If this was extended to individuals aged up to 75, it would provide a single, common and targeted measure which is simple to administer and effective. It also allows all individuals to maximise their participation in the system up to an agreed limit rather than to limit contributions for some members based on their working status. This test can also not be manipulated or falsified unlike the current work test.

We also propose that now is an administratively efficient and opportune time to reconsider removing the work test because of recent complex changes to the work test and spousal contributions, including a work test exemption. For example, the recent increase in the spousal contribution age to under 75 is less effective because the spouse must still meet the work test to receive contributions. In addition, the work test exemption provides a one-year exemption from meeting the work test the year after a member, with less than $300,000 in superannuation assets, has retired. Not only is this measure complex but it is extremely limited in its application for superannuation members and it is also not well understood and requires yet another cap ($300,000) to administer.

Proposed solution: Repeal the work test for non-concessional contributions

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

For integrity purposes we don't believe the work test should be removed for voluntary concessional contributions such as personal contributions which are claimed by the member as a tax deduction. Removing the work test for these contributions could result in members over age 67 making a superannuation contribution which is claimed as a tax deduction and then immediately withdrawn from the superannuation system.

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 to give back to society. This measure would also provide more flexibility for individuals who are not be able to find gainful employment especially those aged between 67 to 74.

Another alternative may be to remove the work test for only certain cohorts of member who arguably the current aged based rules discriminate against. For example, a small business owner who sells their business and receive the sale proceeds over a number of years in tranches would be unable to contribute any tranche received once they have reached age 67 (assuming they also don't satisfy the recently retired rule). Similarly members over the age of 67 who receive a compensation payment as a result of a personal injury claim are not able to contribute the proceeds of that claim after attaining age 67 (assuming they don't satisfy the recently retired rule at that time).

A PRACTICAL APPROACH TO NON-GEARED UNIT TRUST BREACHES

Non-geared unit trusts (NGUTs) are a popular investment structure for many SMSFs. They allow SMSF trustees to pool money with other investors, who may or may not be related, to invest in property. These trusts are permitted under the superannuation legislation if they comply with strict criteria under Division 13.3A of the SIS Regulations. When requirements are not met, the units held by an SMSF in the NGUT are regarded as an in-house asset of the fund.

The SMSF Association believes the practical administrative nature of dealing with breaches to the strict criteria causes an unnecessary cost to SMSF trustees.

The below checklist provides a high-level simplification of the criteria for the unit trust under SIS regulation 13.22C:

- The superannuation fund has fewer than 5 members.
- The trustee of the unit trust does not have a lease with a related party of the superannuation fund. An exception applies if the lease relates to business real property.
- The trustee of the unit trust does not have outstanding borrowings (including small overdrafts).
- The assets of the unit trust do not include:
    - An interest in another entity; or
    - A loan to another entity except a deposit with an authorized deposit-taking institution (eg, certain approved banks); or
    - An asset that is subject to a charge (including a mortgage); or
    - An asset (excluding money) that was ever owned by a related party, subject to certain excluded timeframes. An exception also applies if the asset was business real property acquired at market value.

SIS regulation 13.22B mirrors the above requirement for NGUTs established prior to 28 June 2000.

These criteria must be met at the time of the initial investment by the SMSF. 13.22D regulates trigger events which cause a NGUT to breach regulation 13.22B or 13.22C and render the investment as an in-house asset. These trigger events align with the criteria in 13.22B and 13.22C. For example, if the trustee of the unit trust undertakes a borrowing or invests in a listed share, the unit trust will no longer be a 13.22B or 13.22C unit trust.

Importantly, if any of the requirements of regulation 13.22D are breached, the unit trust ceases to be a 13.22B or 13.22C unit trust. Such a breach can never be rectified. This means a trigger event in regulation 13.22D will taint the unit trust forever for that superannuation fund.

The consequence of this is that the unit trust would then form part of the in-house assets of the SMSF. In that case:

> – if the value of those units breach the 5% limit, ultimately, the fund would need to dispose of its interest in the unit trust (at least up to the 5% limit). This could trigger significant taxation and duty consequences; or
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> – if the value does not breach the 5% limit, the SMSF has the option to retain its investment in the unit trust and, in which case, it would need to continue to monitor the 5% limit.

The SMSF Association believes the penalty for a breach of the 13.22D in unnecessarily strict and impractical. This is because the usual advised remedy is for SMSF trustees to sell the units they hold in the NGUT as required by the law and then re-purchase the same structure.

Regardless of how small a breach is, such as a $1 overdraft, the unit trust is compromised. This includes the approved SMSF Auditor not being able to apply any prospective green tick of approval.

If we assume a NGUT has commercial property valued at $1.4 million and the NGUT is 100% owned by an SMSF and the NGUT then breaches the criteria in reg 13.22C:

- Despite the NGUT owning business real property ('BRP'), the units will need to be transferred from the SMSF as these constitute an in-house asset. As an example, Victorian duty on transfer of these units is $77,000. An exemption may be possible if the transfer is to a member in kind if they are entitled to be paid (eg, attained 65 years). However, in many instances, duty would be payable unless the value of dutiable property in the NGUT was below the relevant threshold (eg, Vic $1m and NSW $2m).
- To facilitate this transfer, the members may wish to retain the property:
    - If we assume it is retained in the SMSF – It would cost approximately $2,000 to establish a new NGUT (including corporate trustee and duty), plus adviser costs of approximately $5,000 and transfer costs of property title to the new NGUT of approximately $5,000.

Therefore, a relatively minor contravention could give rise to around $100,000 in costs.

Alternatively, if the members wish to transfer the property outside super, they may need to arrange borrowings and incur adviser and legal costs. In addition, the usual disposal costs with property would apply.

Proposed solution: Allow trustees to implement a plan to rectify the breach before the end of the following financial year

Therefore, we propose that breaches of regulation 13.22D are able to be rectified in an appropriate period. A breach would still occur but the ability to rectify the breach removes the cost and administrative burden of selling assets and re-purchasing them.

This would be akin to the practical approach taken when trustees breach the in-house asset rules.

The in-house asset rules require the trustees of SMSFs who have assets that exceed the 5% in-house asset limit at the end of a financial year to prepare a written plan to rectify the situation before the end of the following financial year.

The plan must specify the amount that is above the in-house asset limit and set out what steps will be undertaken to reduce the fund's in-house assets to below the 5% limit (generally by disposing or selling excess assets). Each trustee of the fund must ensure that the steps in the plan are carried out within the next year of income.

AMNESTY TO CONVERT LEGACY PENSIONS TO ACCOUNT BASED PENSIONS

A superannuation 'clean up' is desirable for the Government, regulators and the superannuation industry for the purposes of modernisation, simplicity and efficiency.

Despite not being an extremely large segment of the sector, the administrative burden and amount of adviser, ATO and Treasury time and resources that are allocated to the issue of legacy pensions is not insignificant.

With the introduction of the TBC (TBC), we believe it is appropriate and necessary to grant an amnesty period to allow SMSF and small APRA fund trustees to convert their legacy Capped Defined Benefit Income Streams (CDBISs) (defined under SIS regulation 1.06(2), (7) and (8) and the equivalent regulations for annuities under regulation 1.06) to account based pensions.

Legacy CDBISs include:

- Life-time complying pensions and annuities
- Market-linked pensions and annuities commenced before 1 July 2017
- Fixed term or life expectancy complying pensions and annuities

Since 1 January 2006, life-time complying and fixed term and life expectancy complying pensions are no longer permitted to be commenced in an SMSF. However, if the pension was commenced prior to this date, the pension can continue to operate. The 'non-commutable' nature of these pensions meant they received concessional treatment under the now repealed reasonable benefit limit regime. These pensions also receive concessional asset test treatment when assessing eligibility for certain Government income support payments.

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 on their TBC. This is because they have not been able to be established in over a decade. They are difficult to administer, explain and advise on.

The table below provides an overview of the numbers provided by industry participants:

Organisation	Number of lifetime and life expectancy complying pensions	Number of Market Linked Income streams
Australian Executor Trustees SAFs	251	233
IOOF	nil	1,709
Colonial First State		5,000
Class super extrapolation*	3,250	5,700

* Based on 2016 data from a sample of 131,646 funds administered on Class as at 30 June 2017

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. There are many legacy pensions where the costs of administering them is substantial given the relatively low balances.

For example, modifications in section 294-125 of the *Income Tax Assessment Act 1997* (ITAA 1997) allows individuals to determine a 'special value' of a CDBIS. 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 individual's transfer balance account (TBA). This is very problematic if payments are not made evenly, or if the first payment does not even meet the minimum when averaged over the year because it was based on last year's balance.

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 for them to be commuted and restarted with the original special value of these pensions, adjusted for pensions paid since 1 July 2017, replacing the original special value as the amount counted towards the member's 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 primarily designed for account- based pensions. These pensions are difficult to administer and harder to report. There are further complications when an individual has an account-based pension at the same time.

The strict commutation restrictions that apply to a number of legacy pensions (eg, a lifetime pension or MLP can only be commuted in an SMSF or small APRA fund during the member's life if the resulting commutation amount is immediately applied to purchase a MLP) mean that members in receipt of such pensions have been left with limited restructuring options in order to comply with the recent reforms.

Furthermore, the legislation never envisaged a situation where a residual balance could remain after the cessation of a CDBIS. Therefore, there remains considerable legislative uncertainty about what should happen to the residual balance of a lifetime complying pension on the death of the pensioner, particularly in situations where there are no surviving members in the fund.

Due to the Australian Tax Office's (ATO) current reserve guidance and laws, many SMSF members are unable to transition their legacy pension to a traditional modern form of superannuation product in a sensible fashion. This is because the transfer may give rise to an allocation of fund reserves to the member and which may be counted against the member's concessional contribution cap.

Moreover, the $1.6 million TBC cap means that moving from a lifetime pension to an MLP post 1 July 2017 may result in the member exceeding their TBC but not being able to commute the excess due to the non-commutable nature of these pensions. Unless a legislative fix is applied to avoid situations where a non-commutable pension could be 'continually in excess' the ATO will be required to issue an excess determination each year and the member will be required to pay tax on the notional earnings component of the excess each year. This ties up unnecessarily ATO and adviser resources and gives rise to considerable unnecessary costs and complexity.

Also, there are many legacy pensions that are no longer viable from a cost of administration perspective where there are low balances but the member is trapped in by the rules and the costs of administration which are, to a large degree, reducing the pension. It is unfortunate that some members are trapped and hence we see the need for a change of law to allow members to move to a modern account-based pension.

Centrelink are also no longer familiar with these products. We are aware of advisers who have a number of cases where all information was submitted to Centrelink regarding the rollover of a lifetime complying pension to an external MLP supplier in a clear and concise form with references to how it complied with all of the guidelines, and it was delayed for months before being processed due to complexity.

The recent superannuation reforms are failing at accommodating and integrating legacy pensions made under old superannuation laws with complex new laws. Many of the reasons for the restrictions around these products no longer exist. Reasonable benefit limits were removed over 10 years ago and many clients who used them for the Centrelink Assets Test exemption are now receiving minimal benefit.

Example of complexity

Mrs B is age 70 and has a Market-linked pension which her late husband commenced in 2004 as a reversionary pension. Mrs B's account balance as at 1 July 2017 was $17,000 which comprises $4,000 cash and $13,000 of an illiquid asset which cannot be redeemed. Mrs B does not have any assets outside of her Market-linked pension that could be used to purchase the illiquid asset from the fund.

The annual pension payment is $4,630 per annum. The ATO supervisory levy is $259, the audit fee is $300 and annual administration fees are $150, totalling $709 per annum. Whilst the audit and administration expenses would generally be considered to be very inexpensive, the fund expenses represent over 4% of the total account balance – more expensive than any current retail fund offerings. The supervisory levy alone represents 1.5% of the total account balance.

The rules of the Market-linked pension mean that Mrs B cannot commute or otherwise convert the pension to an Account-based pension or accumulation account which would negate the need to maintain an inefficient arrangement.

The annual pension payment and expenses will result in the available cash being exhausted within the year. After this time the fund will not be able to meet its pension payments and will therefore be in breach of the pension standards. In addition, the fund will be unable to pay its ATO supervisory levy.

It would be in the best interest of the member if she were able to take a lump sum commutation of the illiquid asset and wind the fund up as soon as possible.

Proposed solution: Introduce an amnesty period that allows SMSF legacy pension conversion to account based pensions

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We believe a transition 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 towards their TBC is appropriate and desirable.

An amnesty to 'flush out' legacy pensions would also give the opportunity for individuals to take up new more innovative and simpler retirement income products rather than being locked into complex and costly legacy pension products.

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 and resolving current uncertainty of how reserves interact with the TBC and what should happen to these reserves on the death of the pensioner.

Furthermore, the amnesty should only allow for a total commutation of the legacy pension's assets. This would ensure the amnesty contributes to a simpler superannuation landscape for the future.

We anticipate there would be significant uptake of this measure, despite the fact some individuals may lose social security grandfathering outcomes with legacy pensions if they choose to use the amnesty. The benefits resulting from a simpler superannuation pension product, especially for legacy pensions which are unable to function in the current regulatory environment would outweigh the loss of favourable Centrelink treatment for many members.

We believe a minimum 12-month transition time would be appropriate for this amnesty.

Amnesty for reserves

Alternatively, if a full amnesty is not proceeded with, it may be appropriate for an amnesty period to apply with regard to dealing with reserve accounts from legacy pensions. As stated, large reserves which cannot be efficiently allocated to account based pensions or other income stream products are a significant source of complexity in the superannuation system. An amnesty or amendment that allows individuals to allocate more than the current maximum (less than five per cent of their superannuation balance without counting towards the member's concessional contributions cap) each year out of reserves would significantly resolve a complex issue with legacy pensions.

Government should also consider the implementation of longer term 'exit plans' for individuals with legacy pensions. For example, a long term solution that gives individuals the opportunity to roll over their reserves in a more efficient way than the current 'less than 5% per annum' approach may be a necessary legislative change after the implementation of any amnesty. The SMSF Association believes as the reduction in legacy pensions occurs and the number of advisers who understand, and are capable of giving advice on, these complex legacy pension reduces over time, an overarching solution will be required for the industry.

The amnesty could also allow members with significant reserves who have satisfied a relevant condition of release to withdraw the reserves from the super system without having this being treated as a concessional contribution under s 291-25(3) of the ITAA 1997. This would result in those with significant reserves having to deal with and be taxed outside the concessionally taxed super environment. This would address some significant reserve issues within SMSFs relating to legacy pensions.

In addition, there is also no possible mischief associated with the allocation of these reserves. The process is consistent with the sole purpose test to attribute a benefit to the member who generated the reserve which has generally arisen because the investment decisions of the member have produced investment returns that have exceeded the actuarial assumptions.

INTRODUCE AN EFFECTIVE SPOUSAL EQUALISATION MEASURE

The SMSF Association, as highlighted in our original Pre-Budget submission, believes it is appropriate for superannuation to be viewed from the perspective of a 'couple' where it is relevant. Couples make considered mutual decisions in which one partner usually makes sacrifices to support another. This means there should be effective mechanisms to facilitate this approach.

Our call for a spousal rollover followed the recent introduction of the TBC and the lack of opportunity for couples to adjust to its introduction where most have balances heavily weighted to one member. We believe the current spousal equalisation measures cause an inefficient administrative burden that increase red tape for no significant positive outcome.

We proposed that one partner should be able to choose to transfer part of their balance to their partner when nearing retirement. Recently, other superannuation advocacy bodies and research bodies have also indicated their support for spousal measures in superannuation. One of these is the proposal for joint superannuation accounts. The SMSF Association believes this proposal provides similar outcomes to a spousal rollover.

Women currently retire with less superannuation than men – an ongoing problem for the super system. When referencing retirement age (60-64), on average, Australian men enter retirement with $336,360 while women have $277,880 – a sizeable gap.[2]

Typically, it's the male member who is more likely to have had an uninterrupted work pattern and a higher wage and therefore benefited from larger and consistent Superannuation Guarantee contributions. The compounding effect of long-term savings sees underlying differences between gender pay, participation rates and other factors make the retirement gap larger.

In most families, women are still the primary child carers, meaning they spend more time out of the workforce and often return to work part time. There are also larger systemic issues such as the gender pay gap, rise of the gig economy and design of the super system that is not as effective for part-time or low-income earners.

The recent Model of Australian Retirement Incomes and Assets from analysis Treasury stated that while future superannuation balances at retirement will continue to increase for both genders, women's balances will continue to lag men's balances until post 2060.

Typically, the compounding effect of long-term savings, like superannuation, sees underlying differences between gender pay, participation rates and other factors make the retirement gap larger. Given superannuation is based on a percentage of income earned, it is difficult for the majority of women to contribute similar amounts to men over their full working lifetime.

Additionally, the introduction of the $1.6 million TBC has changed the landscape of the superannuation industry, specifically relating to the importance of individual superannuation balances of a couple.

The reforms now mean that on the death of a member, death benefits are much more likely to leave the superannuation system earlier. This is because when a member dies their TBC ceases. Therefore, in absence of any space that can be utilised in a spouse's $1.6 million TBC through a reversionary pension, sums of money must be 'cashed' out of the system as a death benefit lump sum. Previously,

[2] Better Retirement Outcomes: a snapshot of account balances in Australia, ASFA, Ross Clare, July 2019

on death of an individual, the entire death benefit sum would normally revert to a spouse who was entitled to keep this amount in superannuation as a death benefit.

The introduction of the $1.6 million cap also significantly affected the tax paid by many couples in superannuation. Individuals who exceeded this cap were forced to remove money from superannuation or move the money into the 15% taxable accumulation phase. This has had a significant unintended impact on many couples in retirement phase, who did not need to actively manage superannuation balances exceeding a certain size in accumulation individually.

Gaining access to certain superannuation measures such as catch-up concessional contributions are also targeted and restricted by the TSB thresholds. Unequal superannuation balances may mean that certain spouses are unable to access these measures because superannuation has been contributed to only one member of the couple.

Therefore, fund member balance equalisation strategies are more important than ever to ensure members can address imbalance, use the $1.6 million TBC, improve retirement income and death benefit plans, and possibly access other benefits associated with having more equal superannuation balances.

Current strategies in this regard have been to employ a re-contribution strategy, use spouse contribution tax offsets, or spouse contribution splitting. However, these strategies are limited in effectiveness due to contribution threshold and cap restrictions, withdrawal restrictions, and lack of flexibility.

For example, a couple who are retired and over the age of 67 with unequal superannuation balances would be unable to make use of any of these strategies effectively to equalise balances. These members would not be able to make any contributions and therefore cannot make use of spousal contribution measures. Furthermore, they would be unable to employ a re-contribution strategy because they would not have passed the work test.

In addition, an SMSF with two members under the age of 65 who have not met a condition of release may not be able to utilise a re-contribution strategy. The ability for these individuals to employ an effective balancing strategy is limited to spousal contributions which take long time frames and do not have a significant impact.

The main problem with these measures is convincing young couples to take advantage of these strategies. This is because young people tend to concentrate on other issues such as paying off mortgages and educating children. Couples are more likely to consider these strategies when they are approaching retirement where it may be too late to implement effectively. The consultation phase and submissions around the time of the introduction of some of these measures, such as contribution splitting, highlighted these risks.

In addition, couples often pool their finances and have joint bank accounts to run the household. Most retirees will receive a full or part Age Pension and the benefit will be based on our marital status. In contrast, when couples save for retirement, each person is required to have separate accounts which are generally uneven due to workforce issues described above.

In our opinion, the ability for individuals to equalise superannuation balances and make decisions as a couple is extremely limited due to the gender pay gap and the current superannuation regulatory context.

Proposed solution: Introduce an effective spousal equalisation measure

Therefore, the SMSF Association proposes that a spousal rollover measure be introduced for superannuation fund members.

In essence, the measure would allow an individual with a higher superannuation balance to rollover a portion of their superannuation balance to their spouse in order to help equalise balances.

The spousal rollover could be targeted to be used by appropriate cohorts through the use of age limits, times of use, limits on amounts and a TSB threshold.

For example, it may restricted to:

- Individuals under the age of 75
- A 'once off' provision
- A rollover maximum of $1,000,000
- The receiving partner not obtaining a higher balance

Another aspect of the proposal is it would reduce the need for re-contribution strategies to exist. Currently, when applicable to a couple's circumstances, individuals are able to withdraw money from their account as a pension or lump sum withdrawal and contribute this to their spouse's account. The benefit of this strategy for couples is that it allows individuals to withdrawal taxable components and then re-contribute them as non-taxable components. Then, on the death of the individual a greater proportion of their death benefit is paid tax-free to their beneficiaries.

We believe the introduction of a spousal rollover would substantially reduce the need for a re-contribution strategy to address imbalances between spouses. This in-turn is more likely to result in additional tax revenue to Government.

This measure would provide an effective and efficient way to significantly improve the superannuation retirement gap between partners, with particular benefit for women.

It would also provide an attractive opportunity for couples who could restructure their superannuation to make better use of the TBC, facilitate simpler death benefit plans with an ageing population and reduce administrative complexity in retirement without providing a tax 'loophole'.

An example of the potential application for two SMSF members is:

Member	**Age**	**Balance**	**Rollover**	**Balance**
Male	54	$ 652,000	-$ 210,500	$ 441,500
Female	52	$ 231,000	$ 210,500	$ 441,500

Member	**Age**	**Balance**	**Rollover**	**Balance**
Male	61	$1,805,000	-$725,500	$1,079,500
Female	59	$354,000	$725,500	$1,079,500

In the first example, both members would now have the ability to access the concessional catch up contributions as they have balances below $500,000. The couple are not penalised by having one individual sacrifice their working arrangements over parts of their career resulting in a lower balance in retirement for one. In addition, they do not need to engage in a re-contribution strategy.

In the second example, both members of the fund would remain under the TBC and avoid the complexities of administering savings held in both retirement and accumulation phase. It also reduces the complexity in death benefit plans where one individual has a significantly higher balance than their remaining spouse. In addition, tax components remain intact rather than the higher balance spouse potentially removing large taxable components of money through a re-contribution strategy.

This proposal is based on rectifying the superannuation gender gap and the lack of effectiveness of current spousal contribution measures. Removing inefficient and ineffective measures that allow members to split their contributions and allocate some to a spouse with less red tape should be encouraged. These are administrative burdens that members avoid until it is too late. As mentioned above, guidance at the time of implementation of certain spousal measures highlighted this risk.

Therefore, doing away with complex spousal measures, recontribution strategies and cap administration in light of a simple pooling measure means spouses can work together to budget efficiently, implement considered investment strategies and facilitate simpler death benefit strategies with an ageing population.

In essence, a spousal rollover provides for a simple and efficient mechanism where couples at retirement are engaged and are able to plan for their de-accumulation of assets.