# SMSF Association

# Budget Submission 2019 - 2020

## February 2019

Level 3, 70 Pirie Street
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 $755 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 2019-20 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 $755 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 simplicity of the superannuation system and better defining its purpose for the benefit of all Australians.

We submit to the Government that it is now an opportune time to look to define the objective and role of superannuation. Given dynamic policy landscape driven by the Productivity Commission's review of superannuation and the Financial Services Royal Commission, ensuring that superannuation has a clear objective will help drive meaningful and effective holistic policy change.

The SMSF Association also continues to believe that the current contribution caps are inadequate, particularly for Australians approaching retirement age. Restrictive caps do not incentivise individuals to save for their retirement during the years in which making larger contributions to superannuation is financially possible.

We also propose that a spousal rollover measure be introduced for superannuation fund members. This measure will provide an effective and efficient way to significantly improve the superannuation retirement gap between genders and improve equalisation between couples, particularly for women. It also potentially makes the superannuation system simpler as less members will need to comply with exceeding the transfer balance cap.

The need to ensure SMSF advice have undertaken specific SMSF advice education is now supported by both the Australian Securities and Investment Commission and the Productivity Commission. We believe raising the standards of SMSF advice through specific education requirements is essential for the provision of quality SMSF advice to trustees.

Moreover, our submission highlights significant complexity issues impeding the superannuation system. The restrictions facing SMSF members who reside outside of Australia and a host of technical amendments, including an amnesty for legacy pensions, resulting from the introduction of the new super reforms are proposed fixes to smooth implementation, and provide further choice, flexibility and simplicity in the superannuation system.

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# EXECUTIVE SUMMARY

**OBJECTIVE OF SUPER**

The superannuation and financial services industry have been immersed in another year of regulatory change and heavy scrutiny. With the potential for enormous change in the superannuation landscape, the SMSF Association believes it is now an opportune time to look to define the objective and role of superannuation, including what it is supposed to deliver and how all parts of the superannuation system fit together.

The lack of a legislated objective of superannuation is in part responsible for the lack of a holistic policymaking approach to the retirement system and some of the systemic issues uncovered by various Commissions. A move to restart the conversation and make effective changes to improve the system only when necessary is essential for a successful retirement system.

Accordingly, we encourage the Government to revisit the process of legislating the objective of superannuation in 2019.

**INCREASE CONTRIBUTION CAPS FOR OLDER AUSTRALIANS**

The SMSF Association believes that the current contribution caps are inadequate, particularly for Australians approaching retirement age. The current concessional contribution cap of $25,000 per year for older individuals has negatively affected their ability to save an adequate amount of superannuation to be self-sufficient in retirement.

We believe Government policy needs to incentivise and encourage Australians to take ownership of their retirement and contribute to their superannuation, particularly when they have greater financial capacity to do so. For those individuals over 50, this is not overwhelmingly the case.

We recommend that individuals over the age of 50 be able to access a higher concessional contribution cap. We suggest that the cap for individuals over 50 should be set at $35,000. This provides an extra $10,000 per year which can be used by those who are planning for retirement and result in a significant positive impact on their lives.

**CREATE A SPOUSAL ROLLOVER**

The gender retirement gap is an ongoing problem for the superannuation system. Additionally, the introduction of the $1.6 million transfer balance cap and clarification of the 'cashing' of death benefits has changed the landscape of the superannuation industry, specifically relating to the importance of individual superannuation balances of a couple.

Therefore, fund member balance equalisation strategies are more important than ever. 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 and impact of spousal contribution measures.

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 even balances. This measure would provide an effective and efficient way to significantly improve the superannuation retirement gap between genders and improve equalisation between couples, particularly for women.

**SMSF EDUCATION REQURIEMENT FOR SMSF ADVISERS**

The SMSF Association acknowledges questions regarding the quality of advice provided to members of SMSFs. The quality of financial advice provided to SMSF members is crucial to the integrity and performance of the sector. SMSFs are a specialised complex retirement savings vehicle and are distinctly different to large superannuation funds.

Raising the standards of SMSF advice through specific education requirements has long been a policy advocated for by the SMSF Association and a key focus of our mission to lead the professionalism, integrity and sustainability of the SMSF sector. The SMSF Association believes that advisers who provide advice to individuals about SMSFs should have specific SMSF education and qualifications that underpin their advice.

This need to ensure SMSF advice providers are appropriately educated is now supported by both the Australian Securities and Investment Commission (ASIC) and the Productivity Commission and we encourage the Government to implement this requirement.

## SIMPLIFYING THE SUPERANNUATION SYSTEM

Simplifying 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. An amnesty to allow SMSF trustees to convert their term allocated and legacy pensions to account based pensions.
2. Repealing the work test to harmonise contribution rules for older taxpayers with those under the age of 65.
3. Addressing inefficiencies in the current residency rules for Australian superannuation funds unfairly affecting SMSFs.
4. Ensuring that where a transition to retirement income stream (TRIS) holder satisfies a nil cashing restriction condition of release their TRIS is converted to an account based pension (ABP).
5. Removing the requirement for a trustee to obtain an actuarial certificate when a superannuation fund is 100% in retirement phase for the entire year.
6. Allowing trustees the ability to ‘choose’ to have segregated exempt current pension income assets.
7. Streamlining the deductible contributions notice.
8. Simplifying child pensions and the transfer balance cap.

## OBJECTIVE OF SUPER

The superannuation and financial services industry have been immersed in another year of regulatory change and heavy scrutiny. The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry and the Productivity Commission's inquiry into the Superannuation System will result in a large amount of regulatory change for the superannuation and financial services industry.

With the potential for enormous change in the superannuation landscape, the SMSF Association believes it is now an opportune time to look to define the objective and role of superannuation, including what it is supposed to deliver and how all parts of the superannuation system fit together.

The lack of a legislated objective of superannuation is in part responsible for the lack of a holistic policymaking approach to the retirement system and some of the systemic issues uncovered by various Commissions.

Legislating the objectives of superannuation 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 2019.

An objective of superannuation would help drive effective policy and the role of all superannuation funds, industry, retail, profit and SMSFs. In an anticipated year of legislative recommendations, a clear and effective objective will help with the creation of policy.

The take-up rate of Australia's age pension is still relatively significant, despite being affected by the 1 January 2017 age pension taper rate changes. 68 per cent of retirees access some form of age pension, with 39 per cent of recipients on a full age pension.[1] This is a symptom of most existing pensioners not having the full benefit of a complete career with 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.

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 note that the Productivity Commission has recommended that the Government should commission an independent public inquiry into the role of compulsory superannuation in the broader retirement incomes system, including the net impact of compulsory super on private and public savings, distributional impacts across the population and over time, interactions between superannuation and other sources of retirement income, the impact of superannuation on public

[1] The Age Pension in the 21st Century, Rice Warner, 2018.

finances, and the economic and distributional impacts of the non-indexed $450 a month contributions threshold.

This goes to the point that retirement income and objective of superannuation are extremely important issues. However, we believe that the Government should set the objective for the system before such a review is undertaken.

It is essential that any objective not only has a focus on providing retirement income but also ensures that retirees are able to build adequate retirement savings through the superannuation system to manage financial risks of aging and retirement.

For the primary objective and guiding principles to effectively guide retirement income policy, there needs to be a direct link between new policy and the enshrined objective and principles. We believe that any new legislation that affects retirement income policy (e.g. superannuation, taxation, age pension, etc.) should be reviewed against the objective and principles similar to Regulatory Impact Statements or Statement of Compatibility with Human Rights that are carried out in conjunction with introducing new legislation currently.

Building a successful retirement income and superannuation system requires public confidence in the efficiency and fairness of the system. Previous and numerous ad-hoc changes and lack of integration between all parts of the sector have degraded this confidence. A move to restart the conversation and make effective changes to improve the system only when necessary is essential to this process.

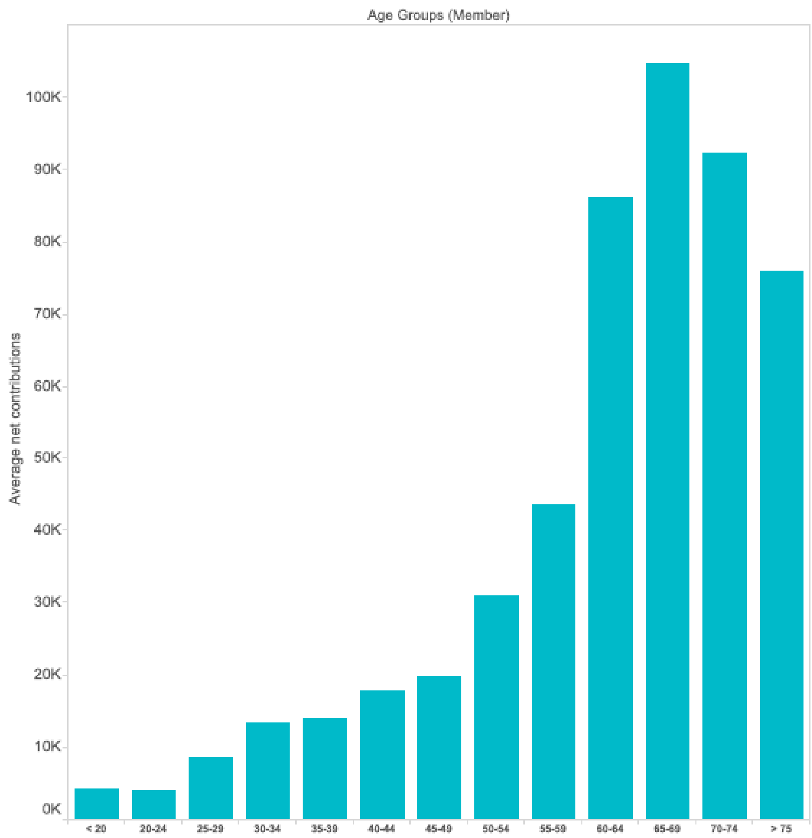
We encourage the Government to consult with the superannuation industry and legislate the objectives of superannuation in 2019.

## INCREASE CONTRIBUTION CAPS FOR OLDER AUSTRALIANS

The SMSF Association believes that the current contribution caps are inadequate, particularly for Australians approaching retirement age. The current concessional contribution cap of $25,000 per year for older individuals has negatively affected the ability to save an adequate amount of superannuation to be self-sufficient in retirement.

The restrictive cap does not incentivise individuals to save for their retirement during the years in which such saving is financially affordable for them. The lack of higher cap for older Australians fails to recognise that most people are able to make voluntary contributions to superannuation 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 lead up to retirement (beginning around age 50) is a critical time period for individuals to plan and grow their retirement savings. These are the final years of full-time work and provide the greatest opportunity with an intersection of financial capability and proximity to retirement.

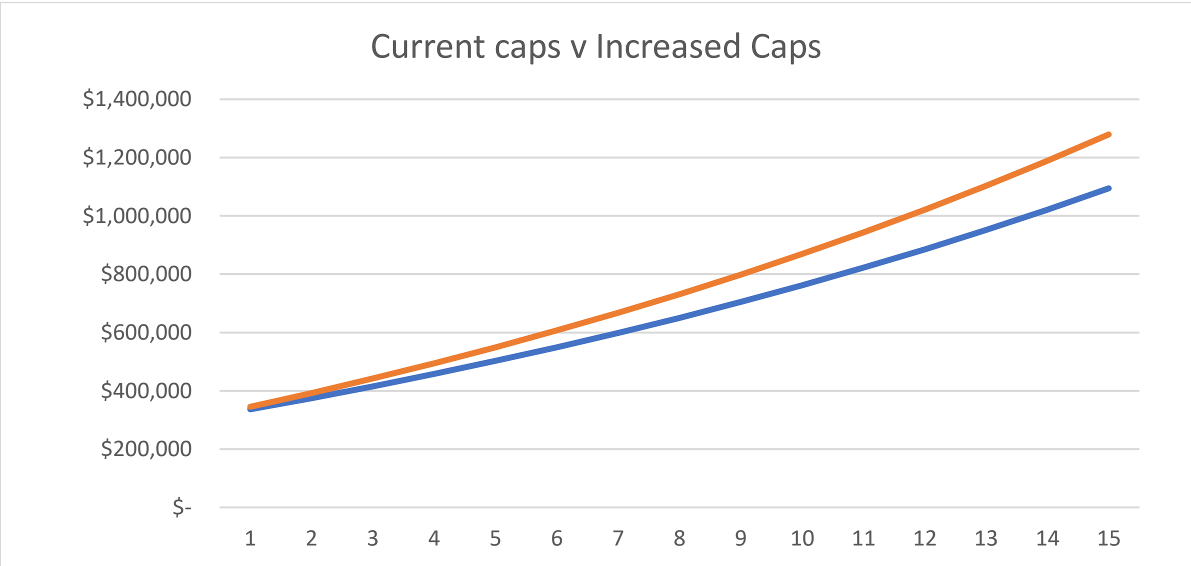
The significant impact that personal contributions can have on superannuation balances at retirement should not be underestimated. The restriction to $25,000 not only lowers retirement savings, it forces individuals to consider other forms of tax effective retirement planning such as investment bonds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

We believe Government policy should incentivise and encourage Australians to take ownership of their retirement planning and contribute to their superannuation accordingly. For those individuals over 50 the policy settings should be improved.

Additionally, given the removal of the 10% rule for personal deductible contributions, more Australians are now able to make concessional contributions. Increasing the concessional contribution cap provides a perfect opportunity to take advantage of this added flexibility.

We recommend that individuals over the age of 50 be able to access a higher concessional contribution cap. We suggest that the cap for individuals over 50 should be set at $35,000. This provides an extra $10,000 per year which can be used by those who are planning for retirement and result in a significant positive impact on their lives.

Notably, the superannuation system previously encompassed a dual contribution cap for individuals at age 50. This provided a more generous cap for those closer to retirement and successfully incentivized those individuals with the ability to save. It was then removed as a policy to discourage high income workers from contributing large amounts of pre-tax dollars into superannuation. However, in the current superannuation system a return to dual contribution caps can now be effectively targeted through the use of the total superannuation balance measures.




The graph above highlights an individual aged 50 with $300,000 in superannuation. In the 15 year lead up to retirement, an increase in the concessional cap to $35,000 results in the member retiring with over $184,000 more in superannuation based on a 6% per annum return.

This would encourage individuals to contribute to their superannuation and, in the long-term, reduce the reliance on the age pension.

## CREATE A SPOUSAL ROLLOVER

### UNEVEN SUPERANNUATION BALANCES AND SUPERANNUATION RETIREMENT GAP

The gender retirement gap is an ongoing problem for the superannuation system. Currently, the average balance for men is around $112,000 and for women around $68,000. According to the 2017 Hilda survey, women retire with half the superannuation savings of men.

Additionally, the introduction of the $1.6 million transfer balance cap (TBC) and clarification of the 'cashing' of death benefits 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 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, 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 taxable proportions of many individuals 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 impact on many individuals in retirement phase, who previously did not need to actively manage their superannuation balance exceeding a certain size.

Due to the recent introduction of the TBC and the lack of opportunity for couples to adjust for its introduction, most couples have balances which are heavily weighted to one member. As stated, typically, this is normally the male member who has more likely had uninterrupted working patterns and a higher wage and benefited from higher superannuation guarantee contributions to superannuation.

In most families, women are still the primary carers of children, which means they spend more time out of the workforce than men, 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 superannuation system which means it is not as effective for part-time or low-income earners.

Therefore, fund member balance equalisation strategies are more important than ever to ensure members can each make the most of their $1.6 million TBC, estate planning, and total superannuation balance thresholds.

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 and impact of spousal contribution measures.

For example, a couple who are retired and over the age of 65 with uneven superannuation balances would be unable to make use of any of these strategies effectively. 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 make a significant impact.

The ability for individuals to even superannuation balances due to the gender pay gap and the current superannuation regulatory context is extremely limited.

## PROPOSED SOLUTION: CREATE A SPOUSAL ROLLOVER

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 even balances.

The following issues would need to be decided by Government:

- The age groups allowed to access the rollover
    - The SMSF Association believes it should be limited to individuals below 75.
- If access should be limited for once off use or multiple
    - The SMSF Association believes there may be merit in access of the rollover more than once but it should be limited to a maximum of three times.
- If access should be limited to an amount that can be rolled over
    - This could be akin to the limit for CGT Small Business Rollovers.
    - It may also be limited by a total superannuation balance threshold.
- If access should enforce that superannuation balances must be evened throughout the process or left to choice of the individual
    - The SMSF Association believes that there is merit in providing choice for the individual but the policy rationale of the measure is to allow for an effective and easier means of evening superannuation balances given the current superannuation regulatory environment and superannuation retirement gap.

This measure will provide an effective and efficient way to significantly improve the superannuation retirement gap between genders and improve equalisation for couples, with particular benefit for women.

It will also provide an attractive opportunity for couples who will be able to restructure their superannuation to better make use of the TBC, meet their estate planning needs and reduce administrative complexity in retirement without providing a tax 'loophole'.

An example of the potential application for two SMSF members:

| **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 second example, both members of the fund will remain under the TBC and avoid the complexities of administering savings held in both retirement and accumulation phase. It also reduces the likelihood that a remaining spouse will be forced to take a significant death benefit lump sum and force retirement savings outside of super upon the death of their spouse.

If both members are in accumulation phase or under the $1.6 million TBC, the rollover has no immediate impact on taxable revenue. However, it improves the superannuation gap, estate planning options and potential application of the TBC in the future. Where a member is above the TBC, there will be a revenue impact due to less retirement savings being taxed at 15% in accumulation phase

## SMSF EDUCATION REQUIREMENT FOR SMSF ADVISERS

The need to ensure SMSF advice providers are appropriately educated is now supported by both the Australian Securities and Investment Commission (ASIC) and the Productivity Commission.

Raising the standards of SMSF advice through specific education requirements has long been a policy advocated for by the SMSF Association and a key focus of our mission to lead the professionalism, integrity and sustainability of the SMSF sector.

As the Productivity Commission stated and we highlight in further detail below, there are current issues with SMSF advice that must be rectified, but without prohibiting informed members from making their own decisions or strangling them with red tape. The Financial Adviser Standards and Ethics Authority (FASEA) are currently lifting the qualification requirements of financial advisers, and these should be extended to require specialist training for those advising on SMSFs.

### CURRENT ISSUES WITH SMSF ADVICE

The SMSF Association acknowledges questions regarding the quality of advice provided to members of SMSFs. As highlighted by Royal Commission's case studies, ASIC Report 575 SMSFs: *Improving the quality of advice and member experiences* and the Productivity Commission's Final Report *Superannuation: Assessing Efficiency and Competitiveness* there are areas of concern. We believe the SMSF industry and advisers should treat scrutiny of the sector as an opportunity to raise professional standards and strengthen advice practices to improve member outcomes.

The SMSF sector is important in both its size and role within the Australian superannuation system, containing almost 30% of superannuation assets. It allows individuals the ability to take control and engage with their superannuation and is also an important source of competitive tension in the superannuation industry.

The fact that members of SMSFs are also the trustees and have direct oversight of their funds means that the issues with roles and responsibilities of intermediaries, governance and conflicts of interest that exist in institutional funds are not prevalent in SMSFs.

However, inappropriate advice provided by 'property one-stop shops' and unscrupulous advisers is an area of fundamental concern to the SMSF Association. We believe the prevalence of this is low across SMSFs, but the detrimental impact to an SMSF member impacted is high.

The 'property one-stop shop' advice model typically occurs when a firm will source a property, provides financing services and completes a client's SMSF accounting and audit. These businesses have inherent conflicts of interest, lack of specialised advice and SMSF skills, and take advantage of customers with limited knowledge of SMSFs. It is therefore important that where SMSFs are advised to invest in property, it is considered as part of a broader retirement strategy. We have advocated for policy solutions that limit the ability of property spruikers to use SMSF limited recourse borrowing arrangements as an investment vehicle for promoting speculative property investments.

ASIC's Report 575 found that advice given in 10% of reviewed files was likely to result in clients being significantly worse off in retirement. The high proportion of files ASIC classified as "non-compliant" did not indicate a risk of financial detriment but attracted scrutiny for not meeting record keeping and process requirements. The SMSF Association believes that advice standards, particularly relating to inappropriate lower balances and unjustified investment advice, need to be improved to rectify these problems.

Nevertheless, the SMSF Association believes the large majority of SMSF advisers, especially those who have invested in specialist education, act in the best interests of their clients by providing justified, trusted and valuable advice.

## WHY SMSF ADVICE IS IMPORTANT TO MEMBERS

The quality of financial advice provided to SMSF members is crucial to the integrity and performance of the sector. Given that the most significant complex changes to superannuation for a decade took effect on 1 July 2017, the need for high quality specialised advice is paramount.

SMSFs are complex structures that are not for everyone. Consequently, SMSF members and potential SMSF members seek advice to understand the myriad of legislative and regulatory conditions applying to SMSFs to determine if an SMSF is appropriate for their circumstances. Notably 63% of SMSFs were established on the suggestion of an adviser and 81% of SMSFs utilise some form of adviser, highlighting that the quality of advice can materially affect the retirement savings of the majority of SMSF members (SMSF Association and Commbank 2017).

Recent research commissioned by the SMSF Association (Commbank 2017 and Russell 2014) also emphasised the numerous and diverse areas on which SMSFs members seek advice. Compliance is the area members require the most help with, closely followed by tax. If members and trustees do not understand their obligations or allocate the time required to manage an SMSF, this can result in severe penalties and sanctions and a lack of effective engagement and management causing significant financial detriment.

Tailored taxation and retirement planning can also provide substantial beneficial outcomes to members. This includes control over pension strategies, timing of asset sales, retirement and financial goals and exit strategies, the benefits of which are hard to measure by a simple return calculation.

When focusing on the areas which trustees value the most, it is investment advice which is most valued. The SMSF Association believes that investment advice, which refers to investment strategy and asset allocation, rather than product or fund selection, is extremely important to the outcomes of members in SMSFs. Advisers have a key role to play in offering strategic holistic investment advice across a member's SMSF and other non-superannuation assets to provide diversified portfolios, the benefits of which are well known. Furthermore, advised client portfolios are much more diversified across asset classes than those of unadvised trustees (Russell 2014).

SMSF advice is necessary, and when provided, is relied upon heavily by members. This means the quality of the advice is extremely important to the SMSF sector. Despite only a small minority of SMSF members stating that the cost of advice was an important factor (Commbank 2017), the SMSF Association believes it is still crucial that advisers exhibit transparency in the costs of advice provided. This includes clear disclosure regarding all fees, potential returns, obligations and compliance.

## HOW TO IMPROVE SMSF ADVICE

### SMSF EDUCATION REQUIREMENT FOR FINANCIAL ADVISERS

The SMSF Association believes that advisers who provide advice to individuals about SMSFs should have specific SMSF education and qualifications that underpin their advice. SMSFs are now a major part of the advice framework making up almost one-third of all superannuation fund assets. As stated, they are complex vehicles that need to be accompanied by high quality and specialised advice, especially given they are only appropriate for certain types of individuals. This was also recommended in ASIC's Report 575 where ASIC stated the results of their review of SMSF advice indicate,

> *"a need to increase the education and training requirements for advice providers who provide personal advice on SMSFs."*

ASIC further stated "a specific SMSF qualification for advice providers wishing to provide SMSF advice" would be under discussion.

The Productivity Commission, as stated previously, now also support specialist training for those advising on SMSFs.

FASEA is the new education standards-setting body which is currently determining the education and training requirements which will be required for advisers to give advice under a 'new' financial advice profession. We believe it would be unfortunate for new advisers to be able to reach the required FASEA threshold to give financial advice and be able to give SMSF advice without specific SMSF knowledge being part of the required learning outcomes. This is essential given that SMSFs are a specialised retirement savings vehicle and are distinctly different to large superannuation funds. SMSF advice requirements should not be a minor subset of financial advice education requirements of superannuation or retirement advice. This is especially pertinent when SMSF trustees, due to the self-directed nature and complexity of SMSFs, are susceptible to poor financial advice with potentially significant detrimental outcomes to individuals.

The table below compares the learning outcomes relating to superannuation in a graduate diploma of financial planning to a graduate certificate in SMSFs. It highlights the difference in specialist SMSF education and broader superannuation/retirement education that can be undertaken by financial advisers. A broad high-level education approach does not give an adviser enough insight to reach a threshold where they can comprehensively advise on SMSFs. For example, complex SMSF limited recourse borrowing arrangements, business real property and related party transaction issues are not discussed in any material detail in the current education standards for advisers but involve significant strategic and compliance issues for SMSF trustees.

The following is a comparison in learning outcomes between a broader financial planning post-graduate qualification in superannuation and an SMSF focused qualification:

| **Graduate Diploma of Financial Planning (Kaplan Professional: Superannuation and Retirement Advice)** |
|---|
| • Analyse superannuation structures and strategies for various client situations.<br>• Explain the taxation implications of superannuation strategies for contribution, withdrawal and insurance at the fund level.<br>• Analyse superannuation retirement income stream strategies according to their benefits, tax implications and social security treatment as they relate to different client situations.<br>• Formulate strategies to maximise superannuation benefits and clients' entitlements to social security benefits and aged care.<br>• Discuss the advantages and disadvantages of equity release schemes as a source of retirement income.<br>• Design superannuation strategies in respect of divorce, bankruptcy and death benefits.<br>• Develop a compliant statement of advice (SOA). |
| **Graduate Certificate in Self-Managed Super Funds (Kaplan Professional)** |
| • Explain how the different SMSF-related occupations can contribute to the optimal operation of an SMSF.<br>• Integrate regulatory and legislative requirements into SMSF advice functions.<br>• Research, assess and apply best practice methodology to the operation of an SMSF.<br>• Critically review relevant contemporary behavioural finance models.<br>• Evaluate the application of behavioural finance models in the adviser – trustees.<br>• Research and explain factors resulting in measurable, systemic biases in investment decisions including difference between collective and individual decision-making processes.<br>• Analyse impact of behaviour biases on SMSF fund investment strategies.<br>• Develop a methodology for mentoring and guiding SMSF Trustees.<br>• Elaborate on the differences and similarities between SMSF strategic financial advice and comprehensive SMSF financial advice, with reference to the literature.<br>• Research and explain the strategic purpose of a range of SMSF strategies.<br>• Model a range of strategies to achieve fund/trustee objectives.<br>• Explain to trustees the identified strategy, the associated benefits, risks and restrictions and how it supports the SMSF strategic objective.<br>• Undertake research on significant SMSF auditing issues.<br>• Apply the Auditing Standards to identify compliance issues in an SMSF.<br>• Complete an SMSF audit that is compliant with both Australian Auditing Standards and SIS Regulations.<br>• Create the required Australian Taxation Office reports and Fund reports. |

- Research and explain the legal regulations that apply to SMSFs.
- Research and critically evaluate the special taxation rules applicable to superannuation contributions, superannuation funds and superannuation benefits.
- Develop and critically evaluate an SMSF strategy to deal with regulatory and tax requirements in a complex SMSF scenario.
- Justify an SMSF strategy to deal with regulatory and tax requirements in a complex SMSF scenario.
- Critically analyse a trust deed for compliance, including all compulsory statutory provisions and those provisions that cannot or should not be included.
- Research and explain the common triggers for SMSF Trust Deed review and propose amendments to minimise compliance risk.
- Compare and contrast a range of publically available SMSF trust deeds to determine suitability for use.
- Review SMSF trust deeds using best practice principles.

Currently, we understand that FASEA's approach will be to settle general financial advice standards before addressing specialist areas such as SMSFs. While this approach fits with FASEA's need to implement standards by 1 January 2019 we believe it forgoes a substantial opportunity to lift the standard of SMSF advice. Given this opportunity to create new professional standards, the Government could consider recommending that FASEA should mandate an increase in SMSF education and advice standards.

Not only would raising the education standards of SMSF advisers increase their knowledge relating to specific and complex legislation, it would also discourage advisers who wish to give SMSF advice but have not undertaken specialist SMSF training. For example, there will be many situations where financial advisers who are licensed to give SMSF advice may have not have many SMSFs in their portfolio of clients. These individuals may not have the required level of expertise and experience to deal with complex SMSF issues when they arise infrequently in their working life, yet they are not forced to seek expert support. An SMSF education licensing requirement to provide SMSF advice in this situation would either force the adviser to complete specialist education requirements to advise their SMSF clients or encourage SMSF members to seek licensed advisers whom deal with SMSFs and the specialist issues involved on a regular basis.

Introducing an SMSF education requirement, would also limit advisers who are licensed but have poor knowledge of SMSFs and limited recourse borrowing arrangements from advising on the product. In turn it then discourages property spruikers from entering the SMSF advice market as the education requirement could be too high.

Understandably, the SMSF Association notes education cannot entirely prevent poor and misleading advice, but along with the implementation of other policy measures, it will provide a safeguard for SMSF members from advisers who potentially lack the required knowledge to provide the specialist advice needed for SMSFs. Furthermore, a requirement to seek specialist SMSF advice would restrict the current practice we see in 'one-stop property shops' which the ASIC Report 575 notes as a detrimental path to inappropriate limited recourse borrowing arrangements.

## SIMPLIFYING THE SUPERANNUATION SYSTEM

The superannuation changes implemented on 1 July 2017 provided some of the largest and most complex changes to the superannuation system in a decade. Dealing with regulatory change and uncertainty is commonly cited as the number one area of concern for SMSF trustees and advisers.

Simplifying 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 following proposals put forward by the SMSF Association are intended to help smooth the implementation of new legislation, and provide further choice, flexibility and simplicity in the superannuation system, particularly for SMSF trustees.

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. An amnesty to allow SMSF trustees to convert their term allocated and legacy pensions to account based pensions.
2. Repealing the work test to harmonise contribution rules for older taxpayers with those under the age of 65.
3. Addressing inefficiencies in the current residency rules for Australian superannuation funds unfairly affecting SMSFs.
4. Ensuring that where a transition to retirement income stream (TRIS) holder satisfies a nil cashing restriction condition of release their TRIS is converted to an account based pension (ABP).
5. Removing the requirement for a trustee to obtain an actuarial certificate when a superannuation fund is 100% in retirement phase for the entire year.
6. Allowing trustees the ability to ‘choose’ to have segregated exempt current pension income assets.
7. Streamlining the deductible contributions notice.
8. Simplify child pensions and the transfer balance cap.

### AMNESTY TO CONVERT LEGACY PENSIONS TO ACCOUNT BASED PENSIONS

With the introduction of the transfer balance cap (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 pensions include:

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

These pensions, which were set up under the law in existence 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.

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 administer, explain and advise on.

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 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 primarily designed for account based pensions. These pensions are difficult to administer and harder to report. They are further complicated when an individual has an account based pension at the same time.

Furthermore, for certain legacy pensions that have been commuted, it has resulted in large reserve amounts which are unable to be allocated efficiently. Due to the Australian Tax Office's (ATO) current reserve guidance and laws, SMSF trustees in this situation are unable to transition their legacy pension to a traditional modern form of superannuation product in a sensible fashion. This is restricted by the requirement that allocations are less than five per cent of their superannuation balance each financial year.

The recent superannuation reforms are failing at accommodating and integrating legacy pensions made under old superannuation laws with complex new laws. However, we note that the Government has proposed measures which aim to ensure legacy pensions are more compatible in the current superannuation environment.

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

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 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 and resolving current uncertainty of how reserves interact with the TBC.

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 individuals may lose social security grandfathering outcomes with legacy pensions. 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.

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

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 current maximum (less than five per cent of their superannuation balance) each year out of reserves will significantly resolve a complex issue point 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 less than five per cent of their superannuation balance may be a necessary legislative change after the implementation of any amnesty. The SMSF Association believes as the reduction in legacy pensions occurs and adviser knowledge is further reduced on these products, an overarching solution will be required for the industry.

## REMOVING 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.

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 SMSF Association 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 can be an arduous process, creating unneeded inefficiency. Additionally, this inefficiency corresponds to a rule which is difficult for the ATO to police.

The ability for individuals to increase their contributions often 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 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 to 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.

Another alternative suggestion is to replace the work test with a single total superannuation balance threshold for individuals aged between 65 to 74. This provides 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.

It ensures individuals with balances, for example below $1.6 million, are given the opportunity to contribute. This test can also not be manipulated or falsified unlike the current work test.

## 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.

It involves situations where Australians who are a temporarily resident overseas being 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, which is something the Productivity Commission has condemned.

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 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 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 described 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.

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 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.

Furthermore, current advances in technology allow for an individual to effectively control and manage their superannuation from outside Australia in the same way as if they still resided in Australia, as geographical location is peripheral to the decisions made in running an SMSF.

It should be noted that a contribution as small as one dollar could result in fund failing the active member test. In this case the ATO has no discretion and would be forced to make the fund non-complying. An inadvertent mistake can result in regulatory action with significant tax liabilities applying that could significantly 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 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 and small APRA funds, 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 ordinarily remains in Australia, then an SMSF member can contribute to their fund of our choice.

If the active member test was not removed, then a carve-out for SMSFs where members are temporarily overseas could also be effective in minimising the impact of this outdated provision on SMSFs. This would allow SMSF members working overseas to still make contributions to their SMSF and save for retirement.

Similarly, the Commissioner of Taxation having discretion to not apply regulatory action (i.e. making a fund on-complying) for minor breaches of the active member test could reduce the severity of the existing law.

## 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. 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 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.

## ALLOW CONVERSION OF A TRANSITION TO RETIREMENT PENSION TO ACCOUNT BASED PENSION

We supported the Government's amendments to ensure that where a TRIS holder satisfies a nil cashing restriction condition of release their TRIS is treated in the same way as an account based pension (ABP).

However, we do believe that the law has been made more complex by having two types of TRIS – one with taxable earnings and one without. An extension of this is that one type of TRIS will count towards the transfer balance cap (TBC), while the other will not.

By structuring the amendment this way, the legislation also creates no real incentive for individuals on a nil cashing TRIS to ever convert to an ABP. In practice, these income streams will continue in the industry in more prevalence than ABPs. If an individual did want to convert to an ABP, they would have to do this via the method of commutation and re-commencement and thus the amendment does not ease the compliance burden they normally face.

Having three types of pensions also creates additional complexity for the superannuation industry. SMSF software and service providers must calculate the tax on differing TRISs and collect additional information on conversion date. Financial advisers will have additional burdens in determining the types of TRIS a client has when an adviser gains a new client or an existing client starts a TRIS. Moreover, the disclosure documents seeking to explain the difference between the three types of pension are very complex and lengthy. Actuaries will also need to determine types of TRIS and if a condition of release is met. Finally, trustees and the public do not need the inclusion of a third income stream that adds confusion and principally functions no different to an ABP.

### PROPOSED SOLUTION: TRIS CONVERTS TO AN ABP UPON CONDITION OF RELEASE

We believe that these unintended complexities can be avoided by adopting a simpler approach of amending the *Superannuation Industry (Supervision) Regulations* 1994 so that where a TRIS holder satisfies a nil cashing restriction condition of release their TRIS they can automatically be converted to an ABP upon an acknowledgment from the member.

This allows existing TRIS to still be grandfathered for Centrelink purposes if they started before 1 January 2015, as the income stream will not have ceased. Furthermore, having members decide when their TRIS converts will also allow them and their advisors to better plan for the transfer balance cap and various other retirement issues and also gives them control. This is an essential aspect of the new superannuation reforms.

## REQUIREMENT FOR AN ACTURIAL CERTIFICATE WHEN FUND IS 100% IN RETIREMENT PHASE

From the 2017-18 income year onwards, if an SMSF has at least one retirement phase income stream at any time of the year and:

- a fund member has a total superannuation balance over $1.6 million immediately before the start of the relevant income year, and
- that member is receiving a retirement phase income stream from any source including the SMSF or another super provider

the SMSF has disregarded small fund assets and will need to use the proportionate method to calculate exempt current pension income (ECPI) for all members for the entire income year. This requires the SMSF trustee to obtain an actuarial certificate that certifies the proportion of income that is exempt.

However, one possible outcome of this rule may result in a fund which is solely in retirement phase for a financial year being required to obtain an actuarial certificate in order to claim ECPI. The actuarial certificate in this circumstance would state an actuarial tax exempt percentage of 100%.

This is an unintended and costly consequence of the disregarded small asset rules which provides no value to SMSF trustees. The requirement to obtain an actuarial certificate to confirm that all the fund's income is exempt from tax when all the assets of their fund are supporting pensions is unnecessary.

### PROPOSED SOLUTION: FUNDS WHICH ARE 100% IN RETIREMENT PHASE DO NOT REQUIRE AN ACTUARIAL CERIFICATE

The SMSF Association proposes that a simple fix to ensure that any fund that is in 100% retirement phase is not required to obtain an actuarial certificate. This could be achieved by amending section 295-385 item 7 to ensure that disregarded small fund assets are not segregated current pension assets, unless section (4) applies in respect to an entire financial year.

This will save SMSFs in this position the annual actuarial fee which is typically between $100 to $200 and not impact Government revenue.

## ALLOW TRUSTEES THE ABILITY TO CHOOSE TO HAVE SEGREGATED EXEMPT CURRENT PENSION INCOME ASSETS

The SMSF Association understands that the ATO's updated interpretation of the definition of segregated current pension assets in section 295-385 of the ITAA 1997 has increased the compliance and burden costs of the SMSF industry for no discernible purpose or gain.

The ATO's updated interpretation is that is when a fund is solely in pension phase,[2] 100% of the fund's assets are used to support pension liabilities, and all its assets are classified as segregated current pension assets at that time. The ATO delayed implementing this interpretation until the beginning of the 1 July 2017 financial year after consultation with industry.

Long standing industry practice has been that unless a fund is solely in pension phase for an entire income year, the trustee can elect to use either the segregated or unsegregated methods when claiming exempt current pension income (ECPI) at the end of the year. This is evidenced in the construction of the ATO's SMSF Annual Return where you cannot select to apply both segregated and unsegregated calculations in the same financial year.

In using the industry preferred and administratively simple unsegregated method for all income earned in the income year, industry relied on the formula in section 295-390 of the ITAA 1997. This formula requires that segregated current pension assets which are held were excluded from the calculation. As the industry determined assets solely in pension phase for part of a year as unsegregated, this formula was not an issue.

However, the ATO's interpretation now means funds are no longer able to elect to use either the segregated or unsegregated method and will have to use a combination of both methods. This is contrary to what has been the ATO's view in cooperation with industry for over a decade. This is supported by the fact that no compliance action has ever been taken on exempt current pension income calculations, a key compliance area for the ATO.

Consultation with our members have determined that this has affected over a third of actuarial certificate applications where at least in one period of the year the fund was solely in pension phase. The interpretation has required significant changes to SMSF administrators' systems and processes, SMSF accounting software as well as for actuarial certificate providers.

The SMSF Association also believes that this interpretation results in no benefit in terms of tax revenue for the Government. ECPI calculations using this method would result in almost nil to no changes in taxation regardless of the interpretation by the ATO. In fact, our members have detailed that the new ECPI method has the ability to be 'gamed' by selling assets specifically on days when the fund is fully segregated.

Below we have highlighted common scenarios including receiving contributions and receiving lump sums that become administratively difficult and result in no differing tax outcome.

The most common scenario involves funds with two members in which both members are in full pension phase at the start of the year due to a commutation and recommencement of accumulation and pension balances. At some stage of the year, both members will normally make a contribution which will sit in accumulation until 30 June. An actuarial certificate will be obtained, and the unsegregated method applied and entered in to the ATO tax return. Generally, the ECPI percentage

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[2] 19A LCG 2016/8

will be returned at upwards of 95%. The trustees will then commute and recommence a pension account from both the current pension and accumulation balance again.

The new interpretation suggests that this approach can no longer be taken for tens of thousands of funds. It suggests that trustees must now either segregate any contributions that are received by the fund into segregated non-current assets or obtain a valuation of all assets at the date of contributions to enable the administrator to apply both the segregated method and unsegregated method (hybrid segregation) effectively and accurately. With regards to the hybrid segregation, in order for the actuary to calculate the tax exempt proportion accurately, they would need to know the value of the fund's liabilities at the point the assets became unsegregated. This would require the fund's assets to be revalued and reports to be created at the time of a contribution during the year. Both of these methods provide a gross increase in administrative burden and both methods provide almost no different outcome in the receipt of taxation for an SMSF.

Therefore, we believe it is appropriate for a legal change which allows trustees to 'choose' to be segregated rather than be 'deemed' to be segregated. We understand the ATO would be open to this legislative change as they were no longer able administer the law as per industry practice upon further analysis of the law.

That is, if assets have been segregated current pension assets at some point in time during a year, the law should state this should not impact upon a fund's ability to calculate its exempt current pension income through the proportionate method in s 295-390 at the end of the year.

As long as a fund had both pension and accumulation assets at some point in the year and no assets were 'documented' to employ a segregated approach then the fund can be considered to be unsegregated.

It is our opinion that employing a strategy with segregated pension assets is a 'decision' of the fund and the fund must document in advance the decision to employ this strategy for specific assets. It should be something that just occurs during the year at any point the fund happens to solely support pension liabilities

This will result in ECPI being administered in the simpler industry approach without creating an unnecessary compliance burden on SMSF trustees, administrators and actuaries with no meaningful revenue gain or integrity benefit.

## STREAMLINE TOTAL SUPERANNUATION BALANCE THRESHOLDS

Introduced on 1 July 2017, an individual's total superannuation balance (TSB) has been used to determine an individual's ability to access certain superannuation concessions. The SMSF Association has been supportive of this method as an effective way to target 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 the ability for an individual to understand the superannuation system and their options increasingly difficult.

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 transfer balance cap 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.

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, when errors are made by trustees it can result in breaches of contribution caps which can be administratively hard to resolve and involve penalties.

## PROPOSED SOLUTION: AMEND TSB LEGISLATION THRESHOLDS

The SMSF Association proposes the following amendments which will 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 contributions threshold
    a. This will reduce the amount 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 incur a significant revenue cost to the Government.
2. Phase out the $1 million quarterly threshold within two to three years
    a. This will further reduce the amount 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 thresholds.
    a. This will reduce the complexity involved in making bring forward concessional contributions when nearing the $1.6 million TSB threshold. We believe a simpler superannuation system will allow all individuals who under 65 and under $1.6 million the ability to make the full $300,000 bring forward non-concessional. This reduces the ability for confusion and complexity in the system and also allows individuals to increase their superannuation and provide for their retirement. We do not anticipate that this will incur 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 will also result in the use of one single $1.6 million threshold for non-concessional, spousal and co-contributions which aligns with the segregated pension threshold and the general transfer balance cap.

We also believe that the definition of an individual's TSB should be amended to reflect their member's benefit statement in their superannuation tax return and financial statements. Currently, an individual's TSB represents their accumulation phase interest and retirement phase interest and what would become payable if the individual voluntarily caused their interests to cease. This equates to the net realisable value of their interests, which could take into account tax and cost associated with realising the assets.

The market valuation regulations that apply to SMSFs under SIS Regulation 8.02B which exclude the cost of realisation do not apply to the TSB definition. We therefore believe, that for simplicity that an individual’s TSB is akin to their member balance on financial statements by applying the market value SISR 8.02B to the TSB definition.

This would simplify the application of TSB and improve the understanding of the term for superannuation members, particularly for those using MyGov which will display a different amount to their superannuation statement.

## STREAMLINE THE DEDUCTIBLE CONTRIBUTIONS NOTICE

The SMSF Association believes there is an opportunity to streamline the current notice of intent (NOI) process for claiming a personal super deductible contribution.

Currently, a NOI must be given to a superannuation fund before the end of the day on which the individual income tax return for that year was lodged, or the end of the financial year after the financial year in which the contribution was made.

It is the significant delays in the reporting timelines for the NOI notifications and acknowledgments that can cause unnecessary delays and red-tape when administering superannuation funds and personal income tax returns. The process is also a significant source of complexity in the superannuation system which is difficult for individuals to understand and results in multiple points where mistakes are made.

Section 290-170 of the Income Tax Assessment Act 1997 lists that a NOI to claim is also not valid if:

- The person is no longer a member of the fund.
- The trustee no longer holds the contribution.
- The trustee has begun to pay an income stream.

The latter is most relevant where a member implements a pension re-commencement strategy to ensure the pension accommodates the personal deductible contributions made in the financial year. If the NOI is not received prior to the pension commencing, the contributions will not be personal deductible contributions. This invokes further complexity in the NOI process.

Given the removal of the 10% test which now allows all individuals the opportunity to make personal super deductible contribution, and the increase in real-time reporting, there is a suitable opportunity to increase the efficiency and simplicity of the NOI process for the modern superannuation system.

The SMSF Association believes there is no need for a member to have to provide a superannuation fund with a traditional NOI, instead it should be encompassed and validated in the member’s superannuation and personal income tax return and occur at the time the contribution is made to the superannuation fund.

Under this proposal, the member effectively notifies the ATO about the tax status of contributions with the lodgement of tax returns and the fund at the time of the contribution. The ATO will then be able to conduct data-matching and audit to validate the deduction and contribution.

We believe this proposal has extended utility for the SMSF industry as SMSFs have a greater ability to self-assess their contributions in the year they are received as a concessional contribution. Allowing an SMSF trustee to self-assess recognises the unique trustee/member relationship in SMSFs and acknowledges that despite the dual role, they are one and the same person. This aligns with the ATO’s stance when it comes to SMSF trustees accepting contributions and their level of innate ‘awareness’.

The SMSF can simply report in its annual return the type of contribution and this should improve the ATO's deduction validation process.

We understand, this type of approach could limit some of the timing issues identified by the ATO previously in their review of the NOI process. However, we understand there may be further issues particularly regarding individuals who are unaware of the status of their contributions until later in the financial year to be worked through.

In scenarios where an SMSF has reported a member concessional contribution and the individual has not claimed a deduction for the contribution, the ATO will be able to allow the contribution to continue to be treated as a concessional contribution and the individual can voluntarily amend their tax return to claim a deduction.

If an SMSF has reported a non-concessional contribution and the individual claims a deduction in their personal return, the individual will be denied the deduction through the ATO matching process.

With the steady progression of real-time reporting in the superannuation system, it is logical that the contribution deductible process is updated for the benefit of both members and the regulators at the same time.

## SIMPLIFY CHILD PENSIONS AND THE TRANSFER BALANCE CAP

When a parent passes away, a common strategy is to pay a pension to a minor child from the superannuation death benefit. However, since the introduction of TBC specific provisions for child pensions, its application is significantly more complex and difficult to implement.

Children under the age of 18 or under 25 if financially dependent on the member are able to receive a death benefit pension until age 25. Once they reach age 25, the pension is required to be commuted and paid as a lump sum to the child.

Child recipients of a death benefit income stream from a deceased parent may have a modified transfer balance cap, rather than the general transfer balance cap ($1.6 million in 2018-19).

The normal transfer balance rules apply, but the modified transfer balance cap depends on the deceased parent's super interests. The amount of the modified transfer balance cap applicable depends on range of factors such as:

- Whether the child pension was commenced before 1 July 2017;
- Whether or not the deceased had a transfer balance account and;
- Whether the child is the sole beneficiary of the death benefit.

If the child pension commenced prior to 1 July 2017, the child's modified transfer balance cap is $1.6 million.

If the deceased parent did not have a transfer balance account at the time of their death as they had not commenced a retirement phase income stream, the child's modified transfer balance cap is:

- If the child is the sole beneficiary - the general transfer balance cap or;
- If the child is not the sole beneficiary - the child's proportionate share of the deceased's superannuation interests multiplied by the general transfer balance cap.

If the deceased parent had a transfer balance account at death, the child's modified transfer balance cap is determined by their portion of the deceased parent's income stream that the child receives as an income stream. Where the child's death benefit income stream is partly sourced from accumulation and retirement interest, the amount of the child's modified transfer balance cap will equal the portion sourced from the retirement phase.

If any part of the child pension is sourced from accumulation interest, the child has an excess transfer balance.

The inclusion of a modified transfer balance cap and 'cap increments' based on the amount of children a parent has, and their original source of the death benefit creates a significant amount of complexity. Not only is this difficult for trustees to understand but it is unnecessarily complex for advisers to understand and explain.

Additionally, disabled children are also 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. 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 binding nominations 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: REPEAL MODIFIED TRANSFER BALANCE CAPS AND CARVE OUT CHILDREN WITH DISABLITIES FROM THE TRANSFER BALANCE CAP

The SMSF Association believes that the modified transfer balance cap for children in receipt of a death benefit pension from their parent should be repealed.

We propose that if a child is in receipt of a death benefit pension they are able to use a cap that is of the same value as their parents general transfer balance cap (currently $1.6 million). This would apply regardless of how many children the parent has, and regardless of if the parent had a transfer balance cap at the time of death.

Upon age 25 this death benefit must be cashed out as a lump sum.

This provides an administratively simple solution to the extreme circumstance of the death of a parent. Unfortunately, the current legislation was designed theoretically but without pragmatism.

Furthermore, there is no ability for individuals to 'game' the system or take advantage of simplified TBC measures in the scenario where a children's parent has passed way.

We also believe 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.