SMSF Association Budget Submission 2020-2021

December 2019

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 professional body representing the self-managed superannuation fund (SMSF) sector which is comprised of 1.1 million SMSF members who have over $750 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 advisers and education standards for trustees. The SMSF Association consists of professional members, principally accountants, auditors, lawyers, financial planners 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

The SMSF Association welcomes the opportunity to make a pre-budget submission for the 2020-21 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 $750 billion in assets and over 1.1 million SMSF members. The SMSF sector is an integral part of Australia's superannuation system and economy.

This year our submission focuses primarily on improving the simplicity and accessibility of the superannuation system for the benefit of consumers and those who advise them.

We submit to the Government that now is an opportune time to begin a pathway to improve the framework for which advice is provided in Australia. With the implementation of the Financial Services Royal Commission recommendations underway, they provide a stepping stone to reducing complexity, cost and improving the ability of consumers to access affordable quality advice.

We believe the limited licencing framework has failed and the Government should begin new steps to transition to a new consumer-centric framework which rectifies the current regulatory burden which exists in SMSF advice, raise advice standards and rectifies the advice gap.

In addition, we believe it is also essential that superannuation and SMSF advisers are able to access Australian Tax Office (ATO) portals to facilitate efficient advice. The current complexity of the superannuation system not only requires simplification, which we propose, but also requires advisers to be able to efficiently obtain timely data for their clients. Access to such data is currently restricted to tax agents.

We also propose that a spousal rollover measure be introduced for superannuation fund members. This measure would provide an effective and efficient way to significantly reduce the superannuation retirement gap between partners, particularly for women.

The SMSF Association also continues to believe that the current contribution caps are inadequate, particularly for older Australians. Restrictive caps do not incentivise individuals to save for their retirement during the years in which such saving is financially affordable for them.

Moreover, our submission highlights significant complex issues such as the restrictions facing SMSF members who reside outside of Australia, death benefit complexity and the need for an amnesty for legacy pensions in SMSFs.

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The limited licence framework has failed and hence should be removed and transitioned to a new consumer-centric framework

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The SMSF Association believes there is an opportunity to rectify the current regulatory burden which exists in SMSF advice, raise advice standards and rectify the advice gap

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Provide SMSF advisers and administrators access to ATO portals

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Repeal the work test

Streamline TSB thresholds

Efficiently monitor and provide TBC data to SMSF advisers and administrators

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Create a spousal rollover

Increase the concessional cap for individuals over 50

Remove the two lump-sum limit for death benefits

Clarify who 'owns' a superannuation death benefit interest

Remove the active member test and provide ATO discretion

Extend the central control and management exception to five years

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

EXECUTIVE SUMMARY

UNMET SMSF ADVICE NEEDS

The SMSF Association (SMSFA) recognises that there are impediments in the current regulatory advice model which prevent SMSF trustees from obtaining basic 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 basic SMSF services fit into the entire financial sector regulatory framework for both accountants and financial planners. Essentially, the outcome should improve consumer protection, ensure unscrupulous advice is prohibited and ensure consumers are able to receive basic SMSF advice efficiently.

Accordingly, we encourage Government to address the regulatory framework by transitioning the defunct limited licence to a new consumer-centric framework that raises advice standards and rectifies the advice gap.

REDUCE SUPERANNUATION COMPLEXITY AND INCREASE ACCESS FOR ADVISER SERVICES

Since 1 July 2016, the legislation and complexities in administering superannuation accounts, particularly for SMSFs, has significantly increased. There are numerous thresholds, caps, indexation methods and limits that require constant monitoring and reporting. This is not only difficult for trustees and members but also their advisers who must be privy to that information. In many cases, advisers are unable to access this data in an accurate and timely fashion.

The different total superannuation balances (TSB)s, individualised transfer balance caps (TBC)s and indexation, lack of SMSF adviser access and intended removal of annual TBC reporting is creating excessive complexity in the superannuation system.

We recommend the Government look to authorise access for all advisers of SMSF trustees to Australian Tax Office (ATO) portals to facilitate efficient advice and implement simplification and streamlined reform to some of the complex superannuation measures.

SPOUSAL ROLLOVER

Recent Treasury analysis stated that while future superannuation balances at retirement will continue to increase for both genders, women's balances will continue to lag behind men's balances until post 2060.

Due to the recent introduction of the transfer balance cap (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 highlighted, 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.

The main problem with the current limited spousal measures is convincing young couples to take advantage of these strategies, when 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 and it may be too late to implement effectively.

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

INCREASING CONCESSIONAL CONTRIBUTION CAP FLEXIBILITY

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 superannuation 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.

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.

DEATH BENEFIT MODERNISATION

Death benefit legislation and application is one of the most complex areas of superannuation. Recent changes in superannuation legislation, specifically the introduction of the transfer balance cap and total superannuation balance, and new ATO interpretations have added further complexity to death benefit planning and execution.

The SMSF Association believes that in the interest of simplification, there is a clear case for reform to align parts of the SIS Act and Tax Act that govern the payment and taxation of death benefit rules. This could start with bringing into line the different definition of a 'dependant' as well as consulting on further opportunities.

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 where Australians who are temporary residents overseas are being prevented from making contributions to their SMSF.

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.

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.

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 and small APRA fund 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.

UNMET SMSF ADVICE NEEDS

The SMSF Association (SMSFA) recognises that there are impediments in the current regulatory advice model which prevent SMSF trustees from obtaining basic 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 basic SMSF services fit into the entire financial sector regulatory framework for both accountants and financial planners. Essentially, the outcome should improve consumer protection, ensure unscrupulous advice is prohibited and ensure consumers are able to receive basic SMSF advice efficiently.

Since 1 July 2016, accountants and other advisers must be licensed or authorised with the Australian Securities and Investment Commission's (ASIC) either through a full Australian Financial Service Licence (AFSL) or limited AFSL to provide SMSF advice services. Operating via an exemption, Tax Practitioner 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 relatively underwhelming.

Currently, SMSF trustees who wish to seek simple SMSF advice are either required to seek formal costly financial advice from a licensed 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 is complicated, inefficient, while 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 needs, advisers face high regulatory costs and burden and accountants 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 advice framework and we outline how SMSF and superannuation advice can be improved in this project.

However, we acknowledge that the:

1. The limited licence framework has failed and hence should be removed and transitioned to a new consumer-centric framework.
2. The SMSF Association believes there is an opportunity to rectify the current regulatory burden which exists in SMSF advice, raise advice standards and rectify the advice gap.

Limited Licence Framework has failed

Introduction of the limited licence framework

Prior to the introduction of the AFSL's limited licence regime, an accountants' exemption existed which authorised a recognised accountant to provide advice in relation to the acquisition, disposal and interest in an SMSF. A recognised accountant had to be a member of either the CAANZ, CPA or IPA.

However, it was determined that all financial advice should be afforded the same level of regulatory rigour, irrespective of who delivers the advice. Under the prior exemption, accountants were able to avoid regulation in dealing with SMSFs, which were not defined to be a financial product.

Therefore, the accountants' exemption, which was introduced as a temporary measure, was removed to align with the Future of Financial Advice (FOFA) intention to enable ordinary consumers to obtain access to more affordable and competent financial advice.

From 1 July 2016 advisers have had to be licensed or authorised with ASIC either through a full AFSL or limited AFSL to provide SMSF advice services. Accountants who intended to give SMSF financial advice spent considerable time and money reshaping their businesses to meet the new limited licensing regime. These accountants were required to comply with the then targeted education standards, under ASIC's RG146 standard in superannuation and SMSFs.

Limited licensing was intended to allow advisers to provide a broader range of advice which included 'class of product advice' about the following financial products:

- superannuation
- securities
- simple managed investment schemes
- general insurance products
- life risk insurance products
- bank deposit products

With regards to SMSFs, individuals must have a form of licensing if they recommend or provide a statement of opinion which could reasonably be regarded as having any influence on their client's interest in an SMSF.

This means that if an adviser holds a limited AFS licence, with all available authorisations, they can:

- recommend and establish an SMSF
- make a recommendation in relation to the client's existing superannuation funds when making this recommendation, referred to as super switching advice, or when providing advice to clients on contributions or pensions
- advise on an SMSF investment strategy
- advise whether the client should hold insurance cover directly or through a superannuation fund
- advise which simple managed investment scheme (MIS) would be appropriate for and in the best interests of a client, e.g. cash funds versus equity funds, and
- advise whether shares are an appropriate investment option given a client's relevant circumstances including their tolerance for risk and whether alternative classes of product might be more suitable.

However, as we highlight below the limited licence framework has failed to meet its objectives.

The exemptions and legal obligations from the licence are complex

Advisers who did not wish to get licenced are able to provide certain advice regarding SMSFs if it falls under one of the below categories of advice ASIC have exempted:

- Factual information.
- Taxation advice.
- Traditional accounting services,

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  - eg, preparing financial statements,
- Broad asset allocation advice.
- Advice which does not involve a financial service (often referred to as 'execution only services')

ASIC's Information Sheet 216 aims to provide guidance on these categories. It is explained as,

> *Generally, the exemptions will apply if the financial service happens to be an integral part of or incidental to another type of service typically provided by an accountant – that is, you would reasonably need to provide the exempt SMSF financial service in order to carry out your normal accounting practice.*
>
> *The exemptions operate concurrently, so you may rely on different exemptions for different aspects of your practice.*
>
> *However, it is important to be aware of the limits of any exemption you rely on. Even if you rely on an exemption to provide one type of SMSF service, if you also provide financial product advice recommending an SMSF or particular investments through the SMSF at the same time, this advice will trigger the requirement to be covered by an AFS licence. Operating under an exemption does not remove the requirement to be covered by a licence for other types of financial service.*

Interpreting where an exemption lies and where a licence is needed has been a complex scenario for the SMSF industry. For example, determining how advisers under a taxation exemption may provide advice on the taxation implications of financial products without being covered by an AFS licence is complex and difficult. This exemption allows accountants who are registered with the TPB to provide financial product advice on their client's interest in an SMSF or a financial product they hold through their SMSF, as long as this advice is merely incidental to the tax advice they are providing and not a separate recommendation on the merits of the financial product itself.

Furthermore, advisers who are covered by an AFS licence, including a limited AFS licence, cannot rely on the exemptions. Advisers who are not covered by any AFS licence can provide advice under an exemption, such as broad asset allocation advice, with limited documentation. However, advisers who have become licensed to provide compliant advice cannot provide the exact same advice as an unlicensed adviser without having to undertake extensive fact finding, providing various disclosures and producing complex and costly statements and records of advice. This is another failure of the limited licence regime which treats advisers providing the same advice differently. Indeed, anecdotal evidence suggests that there are many advisers who obtained a limited AFS licence because they thought this might be a wise business decision are now cancelling their licence because of the complexity, cost and uncertainty of the current system.

FASEA ignored the limited licence

The Financial Adviser Standards and Ethics Authority's (FASEA) educational standards, which were recently finalised, failed to "appropriately recognise or account for" the limited licence advice regime, particularly for accountants with a licence providing SMSF advice.

The relevant experience and education needed for accountants giving advice under a limited licence was not adequately considered under the existing pathways framework. The adviser pathways force advisers who only provide SMSF advice to spend considerable time and money studying subjects that are not relevant to the advice they provide. We believe the education and standards that accountants

with a limited licence must undertake should have adequately represented more on the work they conduct on a day-to-day basis.

This means that many advisers with a limited licence face costly and irrelevant study to continue providing specific and specialised SMSF advice, which is the only area of advice they are legally able to provide.

In essence, the limited licence regime was a legislated part of the regulatory framework that was ignored by FASEA. This has now made the limited licence regime much less irrelevant.

Poor take up

The limited licence regime has also not had anywhere near the expected take up in the accounting industry. In 2018-19, ASIC only approved 4 limited AFS licences, compared with 800 full AFS licences.

Going back to 2015-16 highlights a poor history of take up from the beginning when 228 limited AFS licences were approved, followed by 512 in 2016-17 and 23 in 2017-18.

The Government's intention at the time was for the limited AFSL framework to see 10,000 accountants[1] become licensed to provide a much broader range of financial advice than they were previously able to.

This means the remaining advisers either ceased providing SMSF advice, became an authorised representative of a licence holder, obtained a full AFS licence or operate without a licence.

We are anecdotally aware of many advisers currently leaving or choosing not to enter the limited licence regime going forward.

Execution only advice occurring

The fallout from the poor take up of the complex and costly limited licence take up means that a portion of advisers are acting on the reliance of 'execution only' services. 'Execution only' services from an unlicensed accountant provides client documentation that simply states that they, the accountant, are merely executing their client's actions on the direction of the client.

However, an 'execution only' service can be easily manipulated when there is a trusting relationship between an unlicensed adviser and a client. An adviser can provide advice to set up an SMSF but direct the client to indicate that the decision to set up the SMSF was the client's own directive to the accountant and that accountant provided no advice. Encouraging their clients to seek execution only services could be used to avoid the documentation required under a licence.

This approach is generally much cheaper than being licensed and undertaking extensive due diligence, providing AFS related disclosures and creating costly and lengthy statements of advice documentation. This is the unintended consequence of a failed limited licence and advice framework.

Overarching regulatory problem – Not fit for purpose

The overarching problem of the limited licence regime is that it prevents SMSF trustees from obtaining basic SMSF advice they require in a convenient and affordable manner.

[1] http://ministers.treasury.gov.au/ministers/bill-shorten-2010/media-releases/new-form-licence-expands-access-financial-advice

SMSF trustees who wish to seek basic SMSF advice are either required to spend significant money seeking financial advice from a licensed adviser or must act without advice. This means there are important unmet SMSF advice needs in the market.

For example, if an SMSF trustee wanted to seek advice regarding the establishment of a pension from their accountant, unlicensed accountants are unable to provide this simple advice. Licensed advisers are able to provide this simple advice but it involves costly documentation disproportionate to the advice the trustee seeks. The cost of implementing such advice is also considerably higher than most clients are prepared to pay. Therefore, trustees either are not able to access the advice or often do not see the cost-effective value of the advice.

As we highlighted previously and our members indicate, once an adviser chooses to be licensed they are then restricted from wearing their traditional accountant 'hat' when trying to provide services they ordinarily provide without being licensed. The framework has restricted individuals from providing simple SMSF services and added unnecessary complexity to simple tasks.

There are also unwarranted restrictions on winding up SMSFs that reduce consumer protection. If an individual comes to an unlicensed accountant regarding their SMSF and they clearly have an inappropriate balance such as below $40,000 without the capability to increase the balance, the accountant is unable to advise the client that an SMSF is not likely to be in their best interests.

In addition, advisers find it too expensive to be licenced to provide simple SMSF services, which is the main need of SMSF trustees.

Scenarios such as this have prompted the Australian Tax Office[2] to acknowledge there is a need in the market to service the gap between full financial advice and smaller matters which has been caused by the licensing regime since the removal of the accountants' exemption.

It is important to recognise the majority of accountants do not want to provide financial product advice but they do wish to easily be able to help their clients set up pensions, advise on making contributions to their SMSF beyond mere tax advice and winding up their SMSF when they wish to do so and refer their clients to a fully licensed adviser to get appropriate financial product advice, when needed.

It is clear that the current framework is restricting the SMSF industry and the professionals who dedicate their time to provide advice.

The limited licence framework has failed and hence should be removed and transitioned to a new consumer-centric framework.

Proposal for a consumer-centric advice framework

The SMSFA, Financial Planning Association, Chartered Accountants Australia and New Zealand, CPA Australia, and the Institute of Public Accountants have created a joint alliance, calling for a more efficient regulatory framework for advisory services.

[2] ATO Assistant Commissioner Dana Fleming at the Accounting Business Expo in Sydney – March 2019.

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The shared goal of this project is to advocate for reform that reduces complexity, improves efficiency and drives harmonisation to better enable the provision of affordable, accessible and quality advice to business and consumers. This can be achieved through improving the quality of regulation that governs the provision of financial and tax advice, including minimising the burden of regulation on businesses and individuals.

The limited licence framework will form part of this assessment.

The proposal for enabling affordable, accessible and quality finance advice we believe is underpinned by:

- Appropriate education and experience
- A Code of Ethics
- Individual registration or licensing
- Single regulatory regime and regulator
- Appropriate consumer protection, including access to dispute resolution
- Appropriate compliance obligations and costs
- Ongoing CPD obligations, relevant to the advisory services provided

Current issues with SMSF advice and education standards

The quality of financial advice provided to SMSF members is crucial to the integrity and performance of the sector.

SMSFs are complex structures that are not for everyone. Consequently, SMSF members and potential SMSF members seek advice to understand the myriad 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 (SMSFA and Commbank 2017). Furthermore, as the Productivity Commission reported, evidence suggests that clients who form favourable views of advisers tend to maintain those views even when the quality of the advice does not justify their decision.

It is clear that SMSF advice is necessary for most SMSFs, and when provided, is relied upon heavily by members. This means the quality of the advice is extremely important to the SMSF sector.

The SMSFA also acknowledges current issues regarding the quality of advice provided to members of SMSFs. As highlighted by Royal Commissions case studies, ASIC’s Report 575 SMSFs: *Improving the quality of advice and member experiences* and the Productivity Commission’s Draft Report *Superannuation: Assessing Efficiency and Competitiveness* there are areas of concern.

Inappropriate advice provided by ‘property one-stop shops’ and other unscrupulous advisers is an area of serious concern to the SMSFA. We believe the prevalence of inappropriate advice is low across SMSFs, but the detrimental impact to an SMSF member impacted is high.

The Association believes it is imperative that the industry be able to rectify these problems regarding advice standards, particularly relating to inappropriate lower balances and unjustified investment advice.

How to improve SMSF advice – SMSF education requirement for advisers

The SMSFA believes that advisers who provide advice to individuals about SMSFs should have specific SMSF education and qualifications that underpin their advice. As stated, they are complex vehicles that need to be accompanied by high quality and specialised advice, especially given they are only appropriate for some people.

The Productivity Commission in their final report recommended that SMSF advisers should have a form of specialised qualification to provide SMSF advice.

This was also supported in ASIC's Report 575 where ASIC has suggested that SMSF advice would be improved by raising education standards with a specific SMSF qualification for advice providers wishing to provide SMSF advice.

As stated, FASEA, the new education standards-setting body which determines the education and training requirements required for advisers to give advice under a 'new' financial advice profession did not recognise specific SMSF education. It is unfortunate new advisers are 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 problematic 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.

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 properties 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.

We believe the proposal to address unmet SMSF advice needs is a substantial opportunity to lift the standard of SMSF advice through required education.

Not only does raising the education standards of SMSF advisers increase their knowledge relating to specific and complex legislation, it also promotes higher standards for new advisers who wish to give SMSF advice. For example, there will be many situations where financial advisers who are licensed to give advice may have not have many SMSFs in their portfolio of clients. These advisers may therefore 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 advice and legislation deems them appropriate to give a full range of SMSF advice. An SMSF education licensing requirement to provide SMSF advice in this situation will either force the adviser to complete requirements to

advise their SMSF clients or force SMSF members to seek licensed advisers whom deal with SMSFs and the specialist issues involved on a regular basis.

The SMSF Association believes there is an opportunity to rectify the current regulatory burden which exists in SMSF advice, raise advice standards and rectify the advice gap.

INCREASE ATO ACCESS FOR ADVISER SERVICES AND REDUCE SUPERANNUATION COMPLEXITY

Since 1 July 2016, the legislation and complexities in administering superannuation accounts, particularly for SMSFs, has significantly increased. There are numerous amounts of thresholds, caps, indexation methods and limits that require constant monitoring and reporting. This is not only difficult for trustees and members but also their advisers who must be privy to that information. In many cases, advisers are unable to access this data in an accurate and timely fashion.

The different total superannuation balances (TSB)s, individualised transfer balance caps (TBC)s and indexation, lack of SMSF adviser access and intended removal of annual TBC reporting is creating excessive complexity in the superannuation system.

We recommend the Government look to authorise access for all advisers of SMSF trustees to Australian Tax Office (ATO) portals to facilitate efficient advice and implement simplification and streamlined reform to some of the complex superannuation measures. The ATO should also develop application program interfaces (APIs) for SMSF administrators.

Below we highlight some of current complexities in administration and provide four steps that will help reduce red-tape for SMSF trustees, members and advisers.

1. Provide SMSF Advisers and administrators access to ATO portals
   a. There is a lack of access to data for those advisers who need it
2. Remove the work (gainfully employed) test
   a. The work test is easily manipulated
   b. The work test exemption is complex and limited
   c. Legislation to increase the work test age to 67 has not been legislated yet
3. Streamline TSB thresholds
   a. There are multiple TSB thresholds providing unnecessary complexity
4. Develop a practical solution for proportional indexation
   a. With every individual having a different general TBC, the ATO must efficiently monitor and provide this data.

Lack of adviser access

Currently, only registered tax agents (typically accountants) are able to access the ATO portal to get TSB and 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 licenced 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 get information but cannot provide advice and financial advisers are unable to get 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 Tax Practitioners Board 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 emailing it to the 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[3]. He noted it was a frustrating aspect of professionals dealing with TBC reporting or excess TBC determinations.

For example, agents 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 APIs (subject to privacy protection and formal authorisations) for all client members, it would provide the only source of professionally consolidated member information across all funds available. This vital information would maximise SMSF service provider engagement in our common enterprise – to promote 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.

The move to open data and increased API access is an essential next step for the SMSF sector and the only means by which the sector can institute commercially viable operational surveillance to the standard the ATO quite rightly requires.

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 SMSF administrators 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.

Work test complexity

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

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

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.

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.

It is an administratively efficient and opportune time to reconsider removing the work test. This is because the recent introduction of the work test exemption is complex and the announcement to increase the work test to age 67 is yet to be legislated. A removal of the work test will mean these prior measures are not necessary for the superannuation system.

For example, 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. Furthermore, as highlighted, the work test is easily manipulated and hard to verify, meaning individuals are able to 'satisfy' the work test without much rigour in many cases.

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. Moreover, the recently substantially lowered contribution caps and other thresholds and tests that must be satisfied provide the ideal timing to eliminate this complex and unnecessary test.

Proposed solution: Repeal the work test

The SMSF Association proposes the work test be repealed. This will give access to individuals 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 who are not be able to find gainful employment especially the elderly aged between 65 to 74.

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.

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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.

Total superannuation balance threshold complexity

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 challenge 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.

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, when errors are made by trustees it can result in breaches of contribution caps which can be administratively hard to resolve and involve 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 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 TSB 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 (NCC) thresholds.
   a. This will reduce the complexity involved in making bring forward NCCs 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 NCC. 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 NCCs, spousal and co-contributions which aligns with the segregated pension threshold and the general transfer balance cap.

Indexation and complexity monitoring personal transfer balance caps

Every superannuation member has their own personal transfer balance cap, which determines the amount they can transfer into retirement phase income streams. Initially, a client's personal cap will equal the general transfer balance cap in the year they first have a retirement phase income stream count against their transfer balance account. Currently, this is $1.6 million.

Over time, a client's personal cap may differ from the general transfer balance cap due to proportional indexation. Under proportional indexation, the unused portion of the client's personal cap (based on the highest percentage usage of their TBC) will be indexed in line with the indexation of the general transfer balance cap. This is an overly complex situation which will result in every superannuation member having their own personal different transfer balance cap maximum.

The next indexation of the general transfer balance cap is expected to occur on 1 July 2021 where there is likely to be an increase of $100,000 to $1.7 million.

Individuals who haven't used their cap will have a maximum use of $1.7 million, individuals who have used a portion of their cap (based on their highest percentage usage) will fall somewhere between $1.6 million and $1.7 million and individuals who have used all of their cap will remain at $1.6 million.

Due to the complex proportional indexation method, individuals will be required to know their personal transfer balance cap maximum, so they do not incur an excess transfer balance.

Indexation of the general transfer balance cap may also change other caps and limits that apply to individuals who make non-concessional contributions.

An example on the ATO website is provided:

Leanne commenced a retirement phase income stream on 1 October 2017 with a value of $800,000. On 13 May 2019, Leanne commuted $200,000 from her pension and her transfer balance account was debited by $200,000. Although the balance of her transfer balance account when indexation occurs is $600,000, the highest ever balance of her transfer balance account is $800,000.

Leanne's unused cap percentage is 50% of $1.6 million. Leanne's personal transfer balance cap will be indexed by 50% of $100,000. Leanne's personal transfer balance cap after indexation is $1.65 million.

The ATO have begun a transition to warn people of these implications and will need to update their systems to track and display this in a timely fashion.

The calculation and monitoring of indexation and the personal transfer balance cap is complex and introduces another element of confusion in the industry.

Proposed solution: Efficiently monitor and provide TBC data to SMSF advisers and administrators

Apart from the administratively simple solution of providing indexation on a non-proportional aspect which would be costly for the budget, we reiterate that the Government should make the timely monitoring of this data a priority and move to provide all SMSF advisers and administrators access to this data in an efficient way.

This would ensure that the professionals aiding trustees have timely access to their personal transfer balance cap to ensure they do not breach certain thresholds or make excess contributions which can have significant consequences.

SPOUSAL ROLLOVER

The gender retirement gap is an ongoing problem for the superannuation system. Currently, the average balance for men is around $168,500 and for women around $121,000. When referencing retirement age, recent research by the Melbourne Institute showed that, on average, Australian men enter into retirement with $454,000 while women had just $231,000.

Recent MARIA analysis stated that while future superannuation balances at retirement will continue to increase for both genders, women's balances will continue to lag behind men's balances until post 2060.

Due to the recent introduction of the transfer balance cap (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 highlighted, 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.

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.

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.

We believe superannuation should be viewed in the framework as a 'couple' where appropriate. 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.

Additionally, the introduction of the $1.6 million TBC and the ATO's view on the 'cashing' of death benefits have 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.

Gaining access to certain superannuation measures such as catch-up concessional contributions are also targeted through total superannuation balance 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 gain access to 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 the spousal contribution measures.

For example, a couple who are retired and over the age of 65 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 make a significant impact.

The main problem with these measures is convincing young couples to take advantage of these strategies, that 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 and it may be too late to implement effectively. Guidance and submissions around the time of the introduction of some of these measures, such as contribution splitting, highlighted these risks

In our opinion, the ability for individuals to equalise 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 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 total superannuation balance 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 contribute non-taxable components. Therefore, on death of the individuals more of the benefits are tax-free to beneficiaries.

In some instances, this could become the dominant purpose of the strategy. For example, to substantially change or 'flush' the components of superannuation benefits through an artificial withdrawal and re-contribution.

The ATO has stated, "while it is not possible to state categorically that Part IVA will not ever be applied to a re-contribution strategy that is carried out to minimise the tax that might be payable on a death benefit paid to a non-dependant, the Commissioner is very unlikely to apply Part IVA to such an arrangement".

We believe the introduction of a spousal rollover could allow the use of re-contribution strategies to be restricted. This ensures amounts stay as the components they were when they entered into the superannuation system and should provide 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 rather than the higher balance spouse 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. As mentioned above, guidance at the time of implementation of certain spousal measures highlighted this risk.

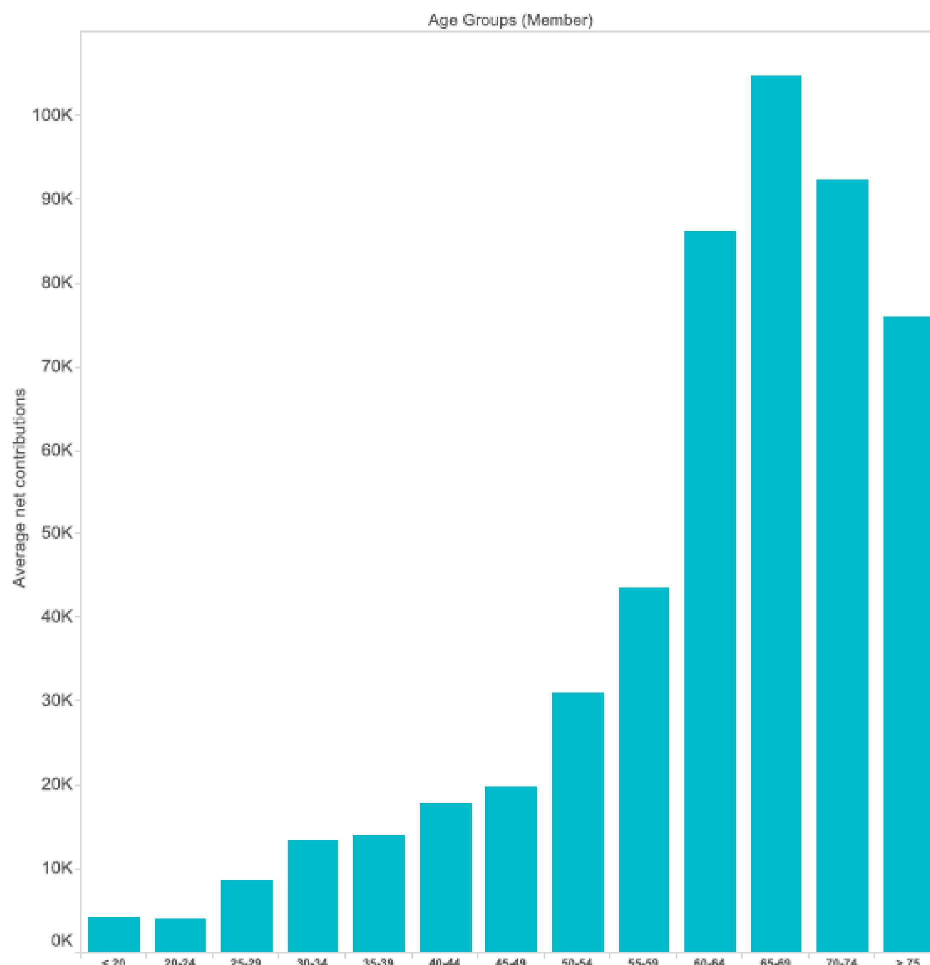
In essence, a spousal rollover provides for a simple and efficient mechanism where couples at retirement are engaged and are able to plan for their de-accumulation of assets.

INCREASING CONCESSIONAL CONTRIBUTION CAP FLEXIBILITY

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 negatively affects the ability to save an adequate amount of superannuation to be self-sufficient in retirement.

The restrictive cap limits the opportunity for many individuals to save for their retirement during the years in which such saving is financially affordable for them. The lack of a 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 and pay 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.



Source: Rice Warner 2016

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The research shows that voluntary contributions form the bulk of SMSF superannuation contributions from around 55 years of age for both genders, and dwarf employer contributions in terms of average value after age 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 encourages individuals to consider other forms of tax effective retirement planning such as investment bonds or negatively geared property investment. When considered with age pension 'black holes' where individuals may appear better off saving less in superannuation because increased taper rates remove Centrelink benefits, the overall disconnect between superannuation and social security policy may lead individuals to neglect superannuation contributions.

We believe superannuation 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.

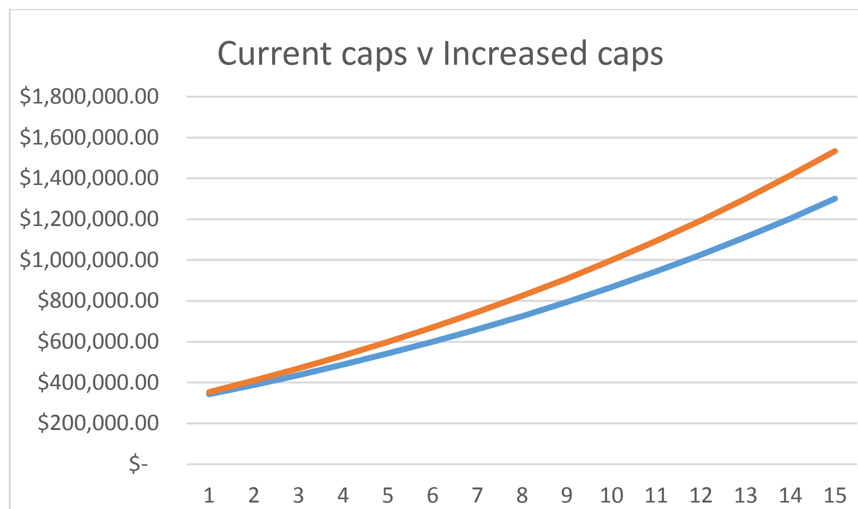
Additionally, since the removal of the 10% rule for personal deductible contributions, more Australians are now able to make concessional contributions. Increasing the concessional contribution cap provides a perfect opportunity to take advantage of this added flexibility.

Proposed solution: Increase concessional cap to for individuals over 50

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 was previously the case several years back and this measure would therefore be easy to reinstate). This provides an extra $10,000 per year which can be used by those who are planning for retirement and which would result in a significant positive impact on their retirement incomes.

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 who had the ability to save. The higher cap was then removed to prevent higher 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.

In addition, the catch-up contribution framework which the SMSF Association supports, is only limited to individuals with a total superannuation balance of $500,000. Once individuals reach this point they become significantly limited in their contribution options.



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.

Costing of increasing the $25,000 to $35,000 for ages 50 and over

We are unable to provide exact costings of the proposal to increase the concessional contribution cap from $25,000 to $35,000 for individuals aged 50 and over. However, the most recent reference is contained in the 2016-2017 Budget Paper.

The proposal to reduce the caps from $30,000 for under 50 and $35,000 for over 50 to $25,000, reduce the Division 293 threshold to $250,000 and include notional and actual employer contributions in the cap for undefined benefit schemes and constitutional protected funds was costed at $2.5 billion.

Therefore our best estimate, detailed below, of the portion that related to only reducing the $35,000 cap for individuals aged over 50 is under $1 billion. As highlighted, individuals over the age of 50 have the greatest capacity to contribute and would most likely form the most significant portion of the contribution changes in the 2016-2017 Budget.

- *Reduce cap from $30,000 for under 50s - $500 million*
- *Reduce cap from $35,000 for over 50s - $1 billion*
- *Reduce Div 293 to $250k - $500 million*
- *Including contributions from undefined benefit schemes and constitutional funds - $500 million*

Indexation

The concessional cap is currently indexed in $2,500 increments based on the average weekly ordinary time earnings indexation factor. The indexation factor of 1.024 for 2018-19 was insufficient to trigger this increase.

At the current rate of wages growth, the concessional cap is therefore not expected to increase to $27,500 until 2023. This is a significant period of time away and further indicates a need to provide individuals the opportunity to contribute more to their superannuation.

DEATH BENEFIT MODERNISATION

Death benefit legislation and application is one of the most complex areas of superannuation. Recent changes in superannuation legislation, specifically the introduction of the transfer balance cap and total superannuation balance, and new ATO interpretations have added further complexity to death benefit planning and exaction.

To 30 June 2018, the Superannuation Complaints Tribunal received 509 complaints about death benefit distributions, representing the largest category of complaints for the financial year. From November 2018 to June 2019, the Australian Financial Complaints Authority (AFCA) received 364 complaints.

Over the past 10 years there has been a constant stream of court litigation that involves superannuation death benefits highlighting the complexity of the legislation.

AFCA confirmed this notion in their Annual Report stating, "they have found there is confusion around who can be a beneficiary, and therefore who can complain to AFCA. "

In addition, some trustees pay out only to a members' deceased estate to ensure that they do not have to deal with death benefit disputes. This attitude limits the ability of a beneficiary to receive a death benefit income stream, ignores tax consequences and social security implications as well as removes the asset protection ordinarily afforded to a superannuation interest.

The SMSF Association believes that in the interest of simplification, there is a clear case for reform to align parts of the SIS Act and Tax Act that govern the payment and taxation of death benefit rules. This could start with bringing into line the different definition of a 'dependant' as well as consulting on further opportunities.

The administrative problems relating to the payment of death benefits are not limited to the SMSF sector and present significant practical concerns for APRA regulated funds. For example:

- It is not uncommon for regular pension payments to continue, before notification is received that a member has died
- Current systems are not designed to indefinitely track a deceased member's superannuation interest.

Retirees must carefully plan their death benefit distribution due to the complex death benefit taxation rules, adverse tax results and to protect from claims by unintended beneficiaries or other claimants.

In accordance with SIS Reg 6.21, a superannuation death benefit must either be paid as a:

- superannuation lump sum, or
- superannuation income stream benefit (pension) that is in retirement phase[4] — this option is only available if paid to a 'death benefits dependant' as defined in the ITAA 1997; or
- as a combination of either.

[4] Para 307-80(3)(aa) ITAA 1997 includes a reversionary Transition to Retirement Income Stream (TRIS) as a retirement phase income stream

In addition, when a member dies, the trustee of an SMSF is required to 'cash' the deceased member's remaining superannuation entitlements (i.e. death benefits) as soon as practicable after the member's date of death (SIS Reg 6.21).

The term 'as soon as practicable' is not defined in either the superannuation or taxation laws. As a general principle, the ATO generally expects payment to be within six months of death unless the trustee can demonstrate valid reasons for the delay.

We believe the following two proposals could be swiftly and simply implemented to modernise and ease some of the confusion in the administration of death benefit payments:

1. Remove the two lump-sum limit rule
2. Clarify who 'owns' a superannuation death benefit interest and therefore who are the beneficiaries.
    - Eg. On the death of an individual who was receiving a death benefit from their deceased spouse, is it the individual's beneficiaries who are entitled to the remaining proceeds or the original deceased spouse's beneficiaries?

Restrictive Two-Lump sum rule

Where the SMSF trustee cashes a deceased member's benefits as a lump sum death benefit, the compulsory cashing requirement is met when the benefits are paid out of the SMSF and superannuation system entirely[5].

The SIS Regs allow for a maximum of two lump sums to each dependant. That is:

- An interim lump sum. This is the value of the member's benefit at the time of death; and
- A final lump sum. This amount cannot exceed the balance of the deceased members' benefits as finally ascertained.

The SIS Regs do not allow for multiple lump sums, with only one or two lump sum death benefits available without breaching the cashing rules. For example, an SMSF cannot 'trickle' out death benefit lump sums to beneficiaries as and when SMSF assets are sold and the cash is available.

Suppose a widow needs a small lump sum from the super fund to pay for the deceased's funeral. Not long after they receive another lump sum to help pay any bills before the super fund life insurance death claim is paid. If the widow would like a lump sum to pay off the house mortgage and other debts, this isn't allowed. Any additional lump sum death benefit would be in breach of the super cashing restrictions.

Where the limit of a maximum of two death benefit lump sums per dependant is exceeded, the trustee will breach the payment standards in Divisions 6.2 and 6.3 of the SIS Regs. This is a breach of the prescribed operating standards relating to the payments of benefits under subsection 31(1) and (2) of SISA for which trustees can be fined. Trustees are personally liable to pay these fines if imposed by the ATO and cannot reimburse themselves from the SMSF's assets.

Another example includes where an SMSF doesn't pay the required minimum pension payment requirements, the death benefit pension will be taken to have ceased at the start of the financial year.

[5] LCR 2017/3 para 60

This means that from the start of that financial year, the member's superannuation interest will no longer be supporting a pension.

Instead, any payments made during the financial year will be treated as superannuation lump sums for both income tax and superannuation purposes. Therefore, multiple lump sum payments that exceed the maximum two limit lump sum cashing restriction, will be a breach of the compulsory cashing requirements. This is not a breach that a trustee can fix. The ATO take a very strict view of what an automatically reversionary pension is as reflected in TR 2013/5 and thus, a reversionary pension will cease if the minimum is not paid for the relevant financial year. This issue also gives rise to considerable unnecessary costs and complexity especially as financial product advice from an AFSL adviser is currently required.

The rules surrounding the TBC are complex and there is a risk that well established strategies to maximise the amount of benefits in retirement phase may also pose a risk of breaching the cashing rules that apply to death benefits. In particular, trustees need to keep track of the maximum two death benefit lump sum limit, per dependant, to ensure there is no inadvertent breach.

For example, it is a widely acceptable strategy for retirement phase pensioners to draw only the required minimum pension payment from their account based pension and top up any additional income requirements with regular lump sum withdrawals from their pension. Regular lump sum partial commutations from an account based pension give rise to a debit in the pensioner's transfer balance account creating space under their TBC.

This strategy may also be appropriate for a beneficiary in receipt of a superannuation death benefit pension.

It is the ATO's current unclarified verbal view that in accordance with LCR 2017/3, whilst a death benefit pension continues to be paid and continues to be in the retirement phase, the compulsory cashing requirement will continually be met under paragraph 6.21(2)(b) of the SIS Regs. In essence, multiple partial commutations from a death benefit pension which result in superannuation lump sums for tax purposes will not invoke the lump sum rule. However, if this clarification is not confirmed then the lump sum rule may be breached by many superannuation funds. This confusion is now becoming a pain point for industry.

If multiple partial lump sum commutations are not at risk of breaching the maximum two limit lump sum cashing restriction, caution still needs to be exercised before a death benefit pension is fully commuted, especially where a death benefit has previously been cashed as a lump sum(s).

Where a lump sum resulting from the full commutation of a death benefit pension is paid out of the superannuation system, further clarity is being sought from the ATO to ascertain whether or not this will be treated as an additional lump sum death benefit that would count towards the maximum two lump sum cashing limit. Adopting a strict application of law has the potential to limit a dependant's ability to fully commute an otherwise fully flexible death benefit account based pension.

For example, if we revisit the widow example from earlier, as she is unable to take any further lump sum death benefits, the only choice afforded to the trustee is to pay the widow a death benefit income stream. Even though the income stream would be an account based pension which would ordinarily allow for partial or full commutation, in this scenario this flexibility is not available. This is because where a death benefit pension is fully commuted and paid out of the superannuation system, the benefit can only be treated as a lump sum as the pension has ceased.

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Proposed solution: Remove the two lump-sum limit for death benefits

The two lump sum rule is an outdated measure that unnecessarily has the ability to restrict an individual from accessing superannuation death benefits as multiple lump sums or paying out a death benefit pension as a lump sum. It gives rise to considerable complexity and administration and also has the potential to negate a common pension strategy undertaken by many superannuation trustees.

We believe this unnecessary restriction is not needed in the current superannuation environment with the compulsory cashing rules designed to ensure that death benefits are dealt with as soon as practicable and with the introduction of the TBC limiting how much money a beneficiary can retain in the concessional superannuation environment. We believe the maximum two lump sum restriction is outdated and does not allow multiple access to lump sum superannuation benefits in the event of common administrative delays, such as delays in receiving insurance payouts in the event of death or managing a recipient's member's transfer balance account. We also believe that this limit is inconsistent with other parts of the law which allow for the flexibility to fully commute an account based pension. For example, the ATO view that each transfer of each share in a company is a separate payment makes it difficult to have a lump sum death benefit pain in-specie. We recommend the two lump sum rule is removed.

Importantly, there is no revenue or integrity risk to this proposal because in the current superannuation environment Individuals are unable to use lump sums to avoid tax and individuals will not be able to 'house' death benefits and 'trickle out' superannuation because they are still required to cash benefits as soon as practicable. In addition, trustees are no longer able to fund an anti-detriment payment which limits the risk of any increased tax deduction claims.

Alternatively, the Government could retain the maximum 2 lump limit but consider amending SIS Reg 6.21 to introduce a new sub reg to allow a lump sum resulting from transfers in kind and the commutation of a retirement phase income stream payable under para 6.21(2)(b) to not breach the cashing restrictions. The risk associated with this recommendation is negligible, with no impact on the operation of the TBC or taxation of death benefits.

Proposed solution: Clarify who 'owns' a superannuation death benefit interest

Unlike lump sum death benefits, the SIS Regs do not place any limitations on the number of pensions that can be commenced from a deceased member's superannuation interest.

With the repeal of sec 307-5(3), (3A) and (3B) of the ITAA 1997 from 1 July 2017, which removed the ability for a surviving individual to turn a deceased's death benefit into their own superannuation interest, the ATO provided an updated interpretation of the law in Law Companion Ruling (LCR) 2017/3[6]. The ATO view is that with the removal of the time restrictions of six months after death or three months after probate from the definition of a death benefit, all benefits paid because of the death of a member will indefinitely be treated as a death benefit in the hands of the beneficiary. This

[6] LCR 2017/3 – Superannuation reform: Superannuation death benefits and the transfer balance cap

means that once a death benefit, always a death benefit and the interest will be continually subject to the cashing rules in SIS Reg 6.21.

Therefore, from 1 July 2017, every single superannuation benefit that arises from the death of a member will ***always*** be a superannuation death benefit.

This means that a death benefit income stream:

- Cannot be rolled back to accumulation; and
- Cannot be mixed with the beneficiary's other superannuation interest(s) at any time.

The ATO has been firm in upholding this view, despite not being universally accepted in the superannuation industry. This means that no matter when the pension started or for how long it has continued to be paid to the beneficiary following the death of a member, the SMSF trustee will be bound by the cashing rules set out in the SIS Regs.

The inherent assumption is that the death benefit pension must, at all times, be treated as a separate superannuation interest to other entitlements that the beneficiary may have in super. This creates an administrative hurdle for superannuation providers to indefinitely track a superannuation interest as belonging to the original, now deceased member, yet treating the amount as a current day member benefit of the beneficiary.

This interpretation also results in confusion about who 'owns' a superannuation death benefit interest and the beneficiaries that are linked to that interest on the death of the beneficiary/ secondary pensioner. That is, on the death of the beneficiary pensioner (irrespective of whether or not the pension was reversionary), clarity is required on whether terms such as "member's benefits", "member's legal personal representative" and the "member's dependants" in SIS Regs 6.21 and 6.22 only refer to the beneficiary pensioner or whether they refer to the original pensioner.

The fundamental question is when does a superannuation interest supporting a death benefit pension sever its link to the original deceased member to become the new pensioner's/beneficiary's entitlement which can be dealt with according to the new pensioner's wishes. This has broad estate planning ramifications as it creates uncertainty when identifying the relevant dependants for super and tax law purposes. This is best explained in the following example:

Richard passes away with $1,000,000 in his superannuation account. Prior to his death he created reversionary pension documentation which provides that his $1,000,000 will revert to his current wife Monica as a superannuation death benefit pension. Monica passes away not long after with the current superannuation death benefit pension now at $800,000. Monica has a death benefit nomination that states her superannuation will be left to a child from her first marriage. However, Richard's son lodges a claim for the $800,000 stating that he should be a beneficiary of the remaining superannuation death benefit pension. The question to be clarified is on the death of multiple pensioners, whose superannuation interest is it, to ensure that the appropriate dependants are identified and death benefits rightfully cashed?

We believe an answer to this question is not sufficiently clear. Given the ATO's recent interpretation it may be arguable that the beneficiaries to the death benefit pension could be Richard's beneficiaries rather than Monica's. In contrast, it may be arguable that Richard has exercised his rights with his reversionary pension and the death benefit interest becomes Monica's interest.

The SMSF Association supports the latter approach for simplicity and continuation, as prior to the ATO's interpretation and new legislation this approach was industry standard.

Without clarification, this uncertainty may induce a significant amount of death benefit disputes going forward from individuals who believe they should be a dependant of a death benefit interest.

The term "dependant" is defined in s10 SIS Act and includes:

- the deceased person's spouse (includes a de facto spouse but not a former spouse)
- the deceased person's child of any age (includes an adopted child, stepchild or ex-nuptial child)
- any person with whom the deceased person had an interdependency relationship just before they died
- any person who was financially dependent on the deceased just before they died (i.e. the common law meaning of dependant).

This broad definition can mean there are multitude of individuals who may have been a dependant of the original deceased member and wish to challenge for a death benefit interest.

We recommend that the Government consider amending the law to clarify that upon the death of a beneficiary/secondary pensioner any residual superannuation benefit arising from a death benefit pension they were in receipt of, be treated as a superannuation member benefit of the beneficiary/secondary pensioner. By ensuring that the link to the original deceased member is not severed until the death of the beneficiary/secondary pensioner, there is little disruption to the intent of the law underpinning the payment and taxation of death benefits. It also ensures that upon the death of the secondary pensioner, the benefits are appropriately cashed in accordance with the secondary member's wishes and relevant dependants.

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 is also equally applies to small APRA funds.

It involves situations where Australians who are a temporary 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 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 both fund administration and compliance costs for the individual affected, reducing their superannuation balance, which is something the Productivity Commission has condemned.

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, 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 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 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.

Confusions regarding the residency test is also one of the most popular topics queried in the SMSF Associations Technical Research Service.

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

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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 fund 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.

Proposed solution: Extend the central control and management exception to five years

We suggest that the two year temporary absence 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 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.

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 a large 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. Further, it is consistent with removing the inefficiencies that exist as a result of members having multiple superannuation accounts.

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 and small APRA fund trustees to convert their lifetime, fixed term and Market-linked (aka term allocated) pensions and legacy pensions (under regs 1.06(2), (7) and (8) and the equivalent regulations for annuities under reg 1.06) 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. (DBPs)
- Market-linked pensions and annuities. (MLPs)
- Fixed term or life expectancy pensions and annuities. (DBPs)

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.

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

Organisation	Number of DBPs	Number of MLPs
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 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 individual's transfer balance account. 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.

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We understand this calculation is also causing resource strain on Treasury to develop a solution regarding a technical legislative error in the way that market-linked pensions are valued under the transfer balance cap when they are commuted or rolled over, resulting in a nil debit.

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. 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, for certain lifetime legacy pensions that have been commuted prior to any restrictions, some of these have resulted in significant 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. Moreover, the $1.6 million TBC cap means that moving, eg, from a lifetime pension to an MLP post 1 July 2017 means that the maximum that can be applied towards funding a fresh MLP is $1.6 million without giving rise to an excess TBC which the ATO are likely to require any excess to be commuted. This ties up unnecessarily ATO and adviser resources and gives rise to considerable unnecessary costs.

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 are too a large degree eating away the pension. This is a real shame that some members are trapped and need a change of law to move to the modern account-based pension

Original documentation regarding these legacy pensions is often not available to check things like the terms and conditions of the pensions including whether they are reversionary and whether they are paid in advance or in arrears.

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 MLP 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 MLP 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 MLP mean that Mrs B cannot commute or otherwise convert the pension to an ABP 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 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.

Restrict to SMSFs or restrict to a low reasonable threshold

We believe it is appropriate for Treasury to limit the amnesty's use to only SMSFs and small APRA Funds. This eases the practical burden of an entire superannuation industry correction. SMSFs are easily able to enact strategies relating to their products because their membership is small, whereas the implications of a broader amnesty may have unintended consequences for defined benefit funds with multiple members.

Another option is to limit the amnesty to legacy pensions that are of small value, such as $100,000. We are aware of our membership who have clients in such a position who find running their SMSF with a legacy pension while in receipt of a Centrelink's age pension was not meeting their needs due to cost and stress. Many advisers are unable to deal with the complexity of the legacy pension, Centrelink advice and SMSF advice and as such leave this client stranded. A potential trial at a targeted amount may provide a soft introduction to flushing legacy pensions when individuals meet this reasonable threshold.

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) each year out of reserves will significantly resolve a complex issue t 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 per annum 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.

Alternatively, the amnesty could 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 and be taxed outside the concessionally taxed super environment and this also gets 'rid' of some significant reserve issues within SMSFs where they relate to legacy pensions.

In addition, there is also no possible mischief associated with 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.