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Director
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The Treasury
Langton Crescent
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Via email: superannuation@treasury.gov.au

Better targeted superannuation concessions

The Financial Services Council (FSC) welcomes the opportunity to make a submission to the Treasury's consultation on the Government's proposal that it would impose a new tax on individuals whose total superannuation balances exceed $3 million.

The FSC wishes to highlight three key areas where we request additional consideration to balance the expected benefit that a simple regime would deliver, the need to ease the significant reporting burden on superannuation funds and also to maintain fairness for impacted individuals. These areas are:

1. Minimising additional reporting processes on APRA-regulated funds – this will require a targeted low-cost reporting solution for proposed measure to minimise the cost burden ultimately borne by superannuation consumers.
2. The lack of indexation of the $3 million threshold - Leaving the decision of when and if to index the $3 million threshold to a future Government does not provide superannuation consumers and the industry with sufficient certainty, and is not consistent with sound long-term superannuation taxation policy.
3. Progressing other related measures in parallel – in particular, to permit the conversion of existing legacy products into more modern products.

Our specific feedback is attached in *Appendix 1: Specific feedback on the proposed measure*, which responds to particular elements Government has proposed in the Treasury Consultation Paper and makes 18 recommendations.

The FSC and its members pass on our thanks and appreciation to Treasury for the opportunity to meet and discuss key issues arising from the consultation.
If you would like to discuss this submission or have any questions, please contact Aidan Nguyen in the first instance on ANguyen@fsc.org.au.

Yours sincerely,

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Appendix 1: Specific feedback on the proposed measure

Aspect of proposed measure	Proposal	FSC Comments and Recommendation
Scope	**No Indexation of the $3 million threshold** The Consultation Paper states that the $3 million threshold will not be indexed.	The FSC **recommends** indexing the $3m threshold so that it retains its real value over time. • In our view, there are genuine questions around the future interaction this unindexed threshold has with the indexed transfer balancer cap threshold. These interaction question are best resolved as part of this phase of the policy design, and not left as a matter for future Governments. • Leaving the decision of when and if to index the $3 million threshold to a future Government does not provide superannuation consumers and the industry with sufficient certainty, and is not consistent with sound superannuation taxation policy. Ideally, these settings would promote public confidence in the superannuation system over the medium to longer term. Not indexing the $3 million threshold undermines this broader objective. As a simpler alternative, the FSC supports and **recommends** withdrawal of balances above the $3m threshold as a one-off process (with appropriate relief provided to facilitate such a process) which would mean the indexation of the threshold would no longer be an issue.
Scope	**No change to Preservation Rules** The Consultation Paper states that the threshold applies to individuals of all ages, even if an individual is not eligible to access their superannuation benefits (i.e. under preservation age or under 65 and still working), and does not propose any changes to current preservation rules.	The FSC **recommends** the Government explore the possibility of changing existing preservation rules for members who have a balance above $3m but are currently unable to withdraw as they do not currently meet a condition of release. This will allow individuals of all ages who would otherwise be subject to the additional tax to withdraw amounts in excess of the threshold. Fund members who have not met a condition of release will be subject to a tax increase with no way to reverse their previous contribution decisions. They contributed to superannuation under rules in place at the relevant time and will now be subject to different rules in relation to the taxation of those benefits within the fund. If this change does not occur, some would perceive the measure to incorporate an element of retrospectivity – people have made additional contributions to their superannuation on the basis of certain tax rules remaining as is i.e., these rules are now changing with no opportunity for those individuals who have not met a condition of release to withdraw these additional contributions. From a legal perspective regarding real or perceived constitutional risks, we make the following comments: • The constitutional basis for the Commonwealth regulation of superannuation funds is not limited to the old-age pensions power. The Commonwealth relies on both the corporations power under s51(xx) of the Constitution or alternatively the 'invalid and old-age pensions' power under s51(xxiii).

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		• Each of these powers (as well as each other express power) impliedly carries authority for the Parliament to legislate in relation to matters incidental to its subject matter (*Grannall v Marrickville Margarine Pty Ltd* (1955) 93 CLR 55, 77). • This is reflected in section 19 of the SIS Act which requires a regulated superannuation fund to either have a trustee that is a constitutional corporation pursuant to a requirement in the fund's governing rules, or ***to have governing rules providing that the sole or primary purpose of the fund to be the provision of old-age pensions***. In practice, it is our understanding that the vast majority of superannuation funds have a constitutional corporation as trustee, meaning that for those funds, the old-age pensions power is irrelevant. • The constitutional landscape was considered at length when SIS was introduced in particular for funds that had individual trustees and relied on the old-age pensions power. There were early concerns that these funds could not allow commutation of the pension benefits written into their trust deeds or could not pay death or disability benefits. Our understanding is that these concerns were resolved on the basis that such features did not detract from the fund having a "primary" purpose of providing old-age pensions (and the flexibility to accommodate a primary, rather than sole purpose of providing pensions was acceptable given the authority to legislate in relation to incidental matters). • In the context of section 19, it seems that a legislative mechanism allowing these withdrawals to occur should not disturb the requirement which is focussed on the framing of the fund's governing rules. • It seems curious for this issue to have arisen in the context of this consultation given the many existing examples of superannuation laws that allow funds to be released from superannuation for reasons other than to provide a pension on reaching "old-age", including under the Division 293 arrangements but also the ability to make withdrawals for first home purchases, COVID relief, death and total and permanent disability. From a practical perspective, it would be hard for impacted individuals to understand and appreciate the Government's decision not to permit early withdrawal of their superannuation monies in their circumstances simply on the presumption of Constitutional Risk. In addition, the FSC **recommends** amending the tax laws to provide a time-limited amnesty (transition period) for those individuals aged less than 60 to permit the tax-free withdrawal of benefits due to this change in law. Currently, those under preservation age would be paying tax of 22 per cent (including Medicare levy) on the taxable component, while those that have reached preservation age and are under the age of 60 would be pay tax of 17 per cent (including Medicare levy) for amounts above the low rate cap amount (currently $230,000).
Calculation of tax liability	**Adjustment for Contributions and Withdrawals** The Consultation Paper states that the value of after	The FSC **recommends** adjusting the calculation used to determine the earnings, and ultimately the tax liability to allow for the following changes to TSBs which can be material for impacted individuals and do not reflect genuine earnings in the individuals' underlying superannuation assets. As outlined below in relation to the additional reporting processes required by superannuation funds, many of these items are not currently reportable under the current MATS/MAAS framework. As such, to maintain simplicity in the design and

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	tax (net) contributions, and withdrawals added to, are subtracted from the closing TSB. This adjustment is necessary to ensure an increase in the closing TSB reflects positive earnings, not amounts an individual has contributed to, or withdrawn from, their superannuation account during the year. Net contributions include SG contributions or voluntary contributions, including downsizer contributions, payment of insurance benefits for policies owned inside superannuation and transfers such as family law splits.	administration in the proposed measure, we would recommend appropriately targeted reporting to limit the cost impact on funds that are ultimately also borne by superannuation consumers. Contributions to be defined to include: • Commencement of death benefit pensions • Receipt of remediation • Receipt of foreign pension transfers (particularly the 'applicable fund earnings' as it does not count towards a contribution cap) • Transfers from reserves • Insurance proceeds (as outlined in the consultation paper) • Low-income superannuation tax offset • Receipt of family law superannuation payment from former spouse • Receipt of concessional contribution splits from spouse • Transfers from KiwiSaver accounts (currently not all receipts count towards a contribution cap) Withdrawals to be defined to include: • Payment of family law superannuation splits to former spouse • Payment of concessional contribution splits to spouse • Amounts released under a release authority (eg excess contributions, division 293 and payments under this measure) • Payments to KiwiSaver saver accounts **Treatment of insurance proceeds** To maintain fairness across impacted individuals, the FSC **recommends** an approach that provides the same treatment between structured settlement contributions and insurance proceeds. As is the case for structured settlement contributions currently, this would require insurance proceeds to be permanently removed from the TSB in all years and not just the first year. This will ensure that those who suffer a significant disability event (e.g. Total and Permanent Disablement) and who will be required to live with this condition going forward are not unduly caught this proposed measure. While the insurance payout might result in the individual's TSB (if left unadjusted) to go over $3 million, the benefit amount and the associated earnings have been designed to see the individual through until the very end of life. The detail of how to correctly exclude insurance proceeds from this measure could be left subject for further consultation. **Alternative for a simpler solution**

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		Applying a deemed rate of return determined by the ATO on the closing superannuation balance each year could be an attractive solution to implementing the proposal because there is: • No need for a formula which adjusts for contributions and withdrawals through the use to calculate notional earnings (not actual earnings); • No additional reporting required by any superannuation funds or changes to the MAAS/MATS reporting for APRA funds; and • Deemed earnings requires less attention to maintain over time, and would be more consistent to the necessary approach required for defined benefit interests. If this approach is accepted, then industry and Treasury could focus on examining a reasonable benchmark or basis for determining the deemed earnings rate. This simplicity would allow time and effort to consider things like long term averages of actual returns. A deemed rate would also not require the taxation of unrealised CGT and could preserve the CGT discount inherent in actual investment returns. For example, these rates could be calculated on a rolling average basis and easily changed to consider current/expected investment market volatility if need be. This alternative method would satisfy the three policy objectives of minimising compliance costs, reducing complexity and ensuring sector neutrality. The FSC **recommends** the Treasury to explore the alternative policy solution of using a deemed earnings rate. We also note that APRA regulated funds report “net investment earnings” in respect of DC members. This might therefore also be used as a basis for determining earnings.
Payment of tax liability	**Option to pay the tax liability** The Consultation Paper states that individuals would have the option of paying their liability either by releasing amounts from one or more of their superannuation interests or by paying the liability from funds held outside of superannuation. It further notes that this is consistent with the approach taken to	To address genuine liquidity issues for impacted individuals having to pay tax on unrealised gains, the FSC **recommends** Government provide impacted individuals with an additional option to pay their tax liability through a deferred debt account. This would look to replicate the current approach given to defined benefit members who are currently required to pay additional Division 293 tax on their concessional contributions. Given the unusual approach adopted by Government in the taxation of unrealised capital gains, the FSC **recommends** Government permit impacted individuals to carry back of capital losses. Another option the FSC **recommends** Government consider is permitting a refund of unused tax credits upon death to the beneficiary (capped at the amount of additional tax paid). Additionally, we note there will be consequential changes required to the ATO release authority element where the member chooses to pay for the tax liability out of their super fund. We **recommend** that the ATO incorporate the option for an individual to pay their liability using superannuation monies into an existing release authority code. Any changes to the existing SuperStream taxonomy would require additional system change to implement. One medium sized FSC superannuation member (>$30 billion in FUM) has estimated this would cost upwards of $2 million to implement.

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	taxes for excess contributions and Division 293 tax.	
Defined benefit interests	**Approach for defined benefit interests** The Consultation Paper states that the Government intends for broadly commensurate treatment to apply to defined benefit interests relative to non-defined benefit interests. The Consultation Paper does not specify a particular approach, and seeks feedback from stakeholders for the required modifications to the general approach outlined for defined contribution schemes as defined benefit interests have different characteristics.	The current formulas for valuing defined benefit and lifetime income stream products used for Transfer Balance Cap calculations are not appropriate. This is because a capitalised value of these benefits will reduce over time as the individual receiving the benefit ages, and expected remaining lifetime shortens. Broadly, there are two options for Government in determining a more accurate basis of valuing benefits in these products / schemes for impacted individuals: an actuarial valuation of the benefit or a prescribed formulaic approach. The more accurate correct method for an actuarial valuation would have significant cost for funds/Government, which would ultimately be incurred by the sponsoring employers, impacted superannuation members, or worse, spread across all fund members. While this may be desirable for some schemes where this information is readily available, the cost-benefit trade-off for an actuarial approach versus a prescribed formulaic approach will likely vary on a case-by-case basis. As such, the FSC **recommends** the Government affording some level of optionality to the treatment of defined benefit and lifetime income products to cater for the wide variety of schemes and products in the industry. The FSC cautions however with providing trustees too much optionality. If this is the case, the outcome will be that they are required to consider both options to determine which is in members' best financial interests, which could result in higher costs and administration burden for superannuation fund consumers. **A simple solution: defined benefit pensions** There is a set of factors currently used in valuing a defined benefit pension for the purpose of family law splits. This would be an appropriate way to smooth the TSB of a defined benefit pension over time with minimal cost to superannuation fund consumers. The earnings subject to the tax could be calculated in the same way as all other accounts, noting that there is a need to calculate a notional contribution amount in the ‘accumulation’ stage as well as recording all payments as a withdrawal in the formula. This will mean that any movement in the calculated TSB net of cash flows will be (appropriately) deemed as earnings and taxable. We **recommend** that a superannuation fund calculates the TSB for a defined benefit interest as the member’s vested benefit, but has the option of applying a different approach where it can be shown that this is the best financial interests of its members. This reflects that it is unlikely that an administrator would be able to calculate anything other than the vested benefit without actuarial guidance. However, to account for those defined benefit interests where a Vested Benefit approach can have significant unintended consequences, we **recommend** that a superannuation fund be able to apply an actuarial approach where it believes this is appropriate (i.e., in the best financial interests of its members). We recommend that the basis applied uses prescribed actuarial factors.

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		Earnings could then be calculated by using the vested benefit multiplied by an assumed deeming rate or by reference to the actual earnings where this is known. In the case of traditional defined benefit pensions, the benefit payable is not related to the fund earning rate (indeed, many exempt public sector funds operate on a pay-as-you go basis and are only partially funded). We **recommend** that consideration be given to a deemed earning rate for calculating earnings for pension phase defined benefits. Deemed earning rates are used for other purposes (e.g. age pensions means testing) – the deemed rate could be a bond yield plus an appropriate margin, or held consistent to another existing deemed rate used by the ATO for other purposes. **A simple solution: lifetime annuities and other lifetime income streams** The family law factors would not easily apply to a lifetime annuity because there would be a discontinuity at most purchase prices. There is a simple alternative that is already used and would involve minimal cost to calculate and report: the Complying Access Schedule (CAS) for Innovative Superannuation Income Streams. Not all purchased lifetime income streams meet the requirements of the CAS. These products usually provide access to capital that exceeds the CAS at some point. It would be appropriate to capture the higher balance available. For products with no capital access at all, the CAS would apply a gradual reduction in capital reflecting the timeframe of the lifetime income stream. An appropriate TSB calculation for a lifetime income stream would be: The greater of: • The Complying Access Schedule (straight line depreciation to life expectancy from the appropriate ALT at the date of purchase); or • Any balance that the owner is able to withdraw from the product. The updated TSB would enable the earnings to be calculated for tax purposes using the standard approach. Generally there will be no contributions, so earnings will be calculated as any payment in excess of the reduction in TSB. Alternatively, a more sophisticated but still simple solution would be to use a valuation/commutation factor together with the Treasury formula. The notional earnings will be driven by the discount rate embedded in the valuation factor (whatever that may be). This will provide for a more consistent approach for lifetime DB pensions and lifetime annuities. **A simple solution: term annuities** Term annuities also use a fixed TSB valuation. For the large number of term annuities that provide for a return of capital at maturity this is appropriate. For term annuities that provide capital back over the term of the annuity, this is inappropriate. A treatment broadly equivalent to the CAS is the deductible amount process currently applied for tax purposes for non-super term annuities. The TSB would be defined as a linear interpolation of the values at purchase and maturity for all times in-between. The TSB could be described as:

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		$$\text{Purchase price} - \frac{\text{Purchase price} - \text{capital available at maturity}}{\text{time since purchase}}$$ For a term annuity with 100% residual capital value, the TSB remains the purchase price throughout the term. For a term annuity with 0% residual capital value, the TSB follows a straight-line path to zero at maturity. Earnings for tax purposes could then be calculated with the formula as proposed by Government.
Reporting process for funds	Treasury have asked for feedback on implementing the proposed changes to fund reporting in a targeted and minimal impact manner.	The FSC strongly supports and **recommends** a simple manual reporting solution to minimise the cost impact of implementing the measure for impacted and otherwise unaffected individuals. Treasury is instead proposing full comprehensive reporting on all individuals in the superannuation system for a measure expected to only impact 80,000 individuals. The FSC **recommends** for the simple manual reporting solution to be in place for at least two years, as the operation and administration of the measure becomes better understood and there is a further decision, at the post-implementation review, to bed the additional tax down as a more permanent process. In combination with indexation of the 3m cap, a reporting system would not be required to capture information on every superannuation member in the country. As stated in the Treasury Consultation Paper, it is estimated that the measure will impact 80,000 individuals when the measure commences from 1 July 2025, meaning that more than 99.5 per cent of individuals with a superannuation account will be initially unaffected. For this reason, the FSC is not supportive of any changes to the MAAS and MATS reporting process beyond what reasonably can be implemented as part of planned enhancements to these frameworks. To provide Government with an indication of costs required for a more comprehensive reporting solution implemented through MAAS and MATS, the FSC provides below a couple of high-level cost estimates of going down this approach received from two FSC members. Importantly, based on these estimates, it would be reasonable to infer that the aggregate cost to the superannuation industry (and to superannuation consumers) would be in the order of several hundred million dollars. 1) FSC Member 1 – large-sized fund (>$60 billion member FUM) A MAAS/MATS build for account-based would cost up to $500k per system (circa $5 million). This project would involve six to eight people at $1,000 a day for three months to build the systems change and perform regression testing to make sure the change is working okay. For this organisation, it would involve doing it for eight superannuation systems including three of which are externally administered. Additionally, impacted insurers may need to do the build too on their systems since they hold insurance-only superannuation interests under sub-administration agreements.

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		In contrast, a manual reporting solution such as through a CSV file extracted from the system database via SQL in response to ad hoc ATO request for withdrawal data for specified members with >$3m TSB would be significantly simpler. 2) FSC Member 2: Cost estimate for a medium-sized fund (>$30b member FUM) would be $3 million for a MAAS/MATS build. This assumes: • The total redemption amount would include ALL withdrawals (for conservativeness). Income Streams, Lump Sums, MCOs (commutations), RTRs (rollovers, which includes release authorities). • Amount redeemed does not conveniently fall under existing MATS categories (member/employer/non-employer contributions, Retirement Phase event, and notice of intent) ○ Closest could potentially be MCO, but assume the ATO will need MCO untouched to avoid impacting existing TBAR processes. • Additionally, potential changes to the MATS taxonomy to accommodate data required. ○ This means that changes will be required at the platform registry to categorise, calculate and export these values in our daily MATS extracts. ○ Changes to data interfaces, convert it into ATO format, and send it to ATO from their platform registries to accommodate the potential new fields into ATO required format.
Other related measures	The FSC understands that Government is considering implementing the announced but unenacted measure to allow commutation of legacy products, as they are aware that this could address some of the issues from this additional tax for affected individuals.	In parallel with this additional tax measure that is proposed to commence on 1 July 2025, the FSC supports and **recommends** implementation, subject to consultation, of the previously announced but unenacted measure to allow individuals to move out of legacy retirement products into modern products (announced in the 2021–22 Federal Budget). The FSC supports the previous Government's announcement to exclude amounts allocated from a reserve supporting the legacy pension from the concessional contributions cap. However, the FSC does not support the previous Government's proposal to tax the allocation from the reserve at 15 per cent as it does not take into account that the monies held in these reserves are not exempt current pension assets and so have already had 15 per cent tax paid on them. Such taxation will result in a loss of capital for these members and potentially act as a deterrent for those wishing to leave these legacy products.