26 April 2024

Director
Retirement, Advice and Investment Division
Treasury
Langton Cres
Parkes ACT 2600

By email: superannuation@treasury.gov.au

Dear Director,

Treasury Laws Amendment Instrument 2024: Better Targeted Superannuation Concessions

The Tax Institute welcomes the opportunity to make a submission to the Treasury in respect of its consultation regarding the exposure draft Treasury Laws Amendment Instrument 2024: Better Targeted Superannuation Concessions (the **draft LI**) and accompanying explanatory statement (the **draft ES**).

In the development of this submission, we have closely consulted with our National Superannuation Technical Committee to prepare a considered response that represents the views of the broader membership of The Tax Institute.

Our detailed comments are set out below.

Notional taxed contributions

We consider that the proposed changes in the draft LI have a broader impact than necessary to calculate a tax liability under proposed Division 296 of the *Income Tax Assessment Act 1997* (**ITAA 1997**). The changes in the draft LI impact how notional tax contributions (**NTC**) are calculated for defined benefit members, thereby impacting:

- tax liabilities calculated under Division 293 of the ITAA 1997; and
- amounts calculated under excess concessional contributions tax.

Feedback from our members indicates that in practice, the proposed changes in the draft LI will impact almost every actuarial assumption currently set out in Schedule 1A of the Income Tax Assessment (1997 Act) Regulations 2021 (**ITA Regs**) relating to how defined benefits are valued in determining NTC. We consider this to be an excessive compliance cost to be imposed on taxpayers and superannuation funds, noting the discontinuation and decline in defined benefit plans generally.

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Defined benefit plans in Australia are predominantly in run-off and are closed to new members. Employer-sponsored defined benefit plans in the private sector often only have a few members in each that are usually structured to be in separate divisions within a master fund. The proposed changes are likely to result in significant compliance costs for superannuation funds, especially as these funds will be required to incur the compliance costs for all of their defined benefit products.

The Tax Institute is of the view that the increase in compliance costs is vastly disproportionate to the target population that is likely to be impacted. Noting the common structures utilised, we consider that small defined benefit plans (such as those with less than $50m in benefit entitlements or less than 67 members) that are closed to new members should be exempted from needing to recalculate the NTC. Further, all defined benefit plans that are closed to new members should be allowed to grandfather and continue using their existing New Entrant Rate that is used in their NTC calculations.

The proposed changes to the prescribed actuarial assumptions for the NTC calculation will not only affect high income individuals that are liable to pay Division 293 tax, they will affect all other defined benefit members by impacting the amount of contribution cap space they have left to make other contributions into superannuation. The Government should clearly articulate the other tax impacts of these changes for employees with defined benefit superannuation and confirm if this is the intended policy outcome. If this outcome is intended, we consider that the draft ES should contain numerical examples demonstrating the overall financial impact over the life of impacted superannuants.

New assumptions

Schedule 4 to the draft LI proposes to change key valuation parameters set out in Schedule 1A and 1AA of the ITA Regs. Importantly, the new proposed prescribed investment return assumption is lower than the current rate, and prescribed life expectancies are higher and have been split between male and female.

The Tax Institute is concerned that the changes will create inconsistent outcomes for taxpayers based on their gender. We consider that the Treasury should include examples in the draft ES showing the difference in outcomes, in annual Division 293 tax liability, and excess contributions cap used up under the proposed rules compared to the current rules. The examples would benefit from a comparison between males and females in the same industry.

If the outcome is that females who are otherwise in the same position as males are more likely to be subject to tax under Division 296 as a result of the amended assumptions, we consider that these assumptions need to be reconsidered. The Tax Institute does not agree with an approach that creates disparate treatment based on gender. In our opinion, Division 296 should not result in gender-based taxation that unfairly discriminates between males and females.

$1 million threshold

Section 307-230A.07 of the draft LI proposes to set a criteria whereby only non-public sector lump sum only interests under the threshold value of $1 million are valued using the vested benefits method. If an interest's value exceeds the $1 million threshold on 30 June of a year, the interest will be valued using the family law valuation method from the following 30 June onwards.

We consider that the proposed threshold is too low and should be increased to reduce the compliance costs associated with funds being required to use the family law valuation method. We also note that the Family Law (Superannuation) Regulations 2001 (the **FMS Regs**) are due to sunset on 1 April 2025 and currently undergoing consultation with the Attorney General's Department. Changes to the FMS regs may introduce changes that impact the draft LI, introducing a degree of uncertainty for taxpayers and superannuation funds.

Proposed shortcut

Section 307-230A.05 of the draft LI provides for a superannuation actuary to issue an alternative valuation certificate if certain criteria are met. One of the conditions for the use of an alternative valuation certificate is that the value determined for each interest would be no less than 90%, and no more than 110%, of the value that would be determined if the family law valuation method were used for those interests.

Feedback from our members indicates that the thresholds of 90% and 110% are quite narrow in practice and will not readily allow a meaningful proportion of funds to use the alternative method. Noting that defined benefits are an ever-decreasing proportion of superannuation accounts, we consider that wider threshold values should be used to ensure that a more reasonable number of funds can avail themselves of the shortcut method and incur fewer compliance costs.

Loss carry-back and debt deferral mechanisms

As a core principle, we consider that there should be tax neutrality between different sectors of the superannuation industry. Steps should be taken to mitigate perceived or actual bias in favour of employees with defined benefits plans or non-defined benefit plans. We consider that a perceived or potential real bias exists in relation to the ability for defined benefit members to defer their tax liability.

Under the existing proposals, defined benefit members are allowed deferred debt accounts to pay their Division 296 tax liability only when they draw their end benefit upon retirement. As noted in our previous submissions to the Treasury and the Senate Economic Legislation Committee, we consider that deferrals should also be allowed for all superannuation funds. We note the particular need in the case of self-managed superannuation funds (**SMSFs**) and super wrap platform accounts (both of which are not pooled investment accounts). This is necessary to mitigate the significant practical challenges resulting from the cashflow mismatch between the tax liability and proceeds from the sale of an asset (an inherent problem with the taxation of unrealised gains).

Unrealised gains may never materialise, and carried forward losses may not be utilised, if the value of assets supporting the account falls and the taxpayer is unable to recoup them. This can result in cases where Division 296 tax will have been levied on a deemed profit that did not materialise. The Tax Institute is of the view that the Government should reconsider the entire notion of taxing unrealised gains for the purposes of Division 296 or at a minimum allow a loss carry-back mechanism in conjunction with broader debt deferral. The current proposed approach of only carrying forward losses is, in our view, insufficient and inconsistent with the debt deferral approach reserved for defined benefits. Further, the proposed approach does not promote sector neutrality.

As highlighted in the examples below, there are other fluctuations in value that could be ameliorated through the availability of both debt deferral and loss carry-back.

- Defined benefit funds, including very large ones, can and have historically become bankrupt due to falls in asset values leaving them unable to pay the promised benefits, especially when the employer-sponsor is also bankrupt or otherwise unable or unwilling to make up the funding shortfall. Superannuants should not be taxed an amount the benefit of which they do not receive.
- Defined benefit members, upon reaching retirement, often opt to take a lump sum that has a lower tax value instead of a lifetime pension. Feedback from our members suggests that such a lump sum has a tax value of generally only around two-thirds of what the pension would have. Although lower, this may be beneficial for some defined benefit members. For example, a defined benefit member with known health issues reducing life expectancy may wish to opt for a lump sum. If such members were subject to Division 296 tax before the lump sum payout, they would have overpaid tax considering the amount that they ultimately received.
- Changes in valuation methodologies, including changes under accounting standards or in regulations about valuation, should not be a trigger for a Division 296 tax liability. Changes in valuation methodology do not represent any real profit. These concerns extend to the impact that the proposed changes to family law valuation regulations used for tax purposes may have.

The Tax Institute is the leading forum for the tax community in Australia. We are committed to shaping the future of the tax profession and the continuous improvement of the tax system for the benefit of all. In this regard, The Tax Institute seeks to influence tax and revenue policy at the highest level with a view to achieving a better Australian tax system for all.

If you would like to discuss any of the above, please contact The Tax Institute's Senior Counsel – Tax & Legal, Julie Abdalla, at (02) 8223 0058.

Yours faithfully,

Scott Treatt
Chief Executive Officer

Todd Want
President