Rollout of Australia’s super tax changes sees further Exposure Draft (ED) legislation in September and consultation in October

Australia’s superannuation tax law is changing to implement the reforms initiated in the 2016 Budget, with consultations occurring in October after the September adjusted policy announcements and further exposure draft law.

The second tranche ED released on 27 September allows superannuation funds and other stakeholders to raise practical issues, unintended consequences and other concerns, prior to the package being finalised. An EY Tax Alert on tranche one is here.

The second tranche includes the showpiece proposal to introduce a lifetime limit with effect from 1 July 2017 on the amount that can be transferred from an accumulation account into a tax-free pension account, to be initially set at $1.6 million. The other key measures contained in the ED materials are to:

- Limit the concessional tax treatment for defined benefit income streams above $100,000;
- Reduce the concessional contributions cap to $25,000 (from $30,000 / $35,000);
- Reduce the income threshold for an additional 15% tax on concessional contributions to $250,000 (from $300,000);
- Introduce a rolling 5 year catch up mechanism for unused concessional contributions cap amounts, for individuals with superannuation balances of less than $500,000;
- Encourage the development of innovative retirement income products, and extend the exemption for income from assets supporting income streams, particularly to deferred income products;
- Restrict the tax benefits for Transition to Retirement Income Streams (TRIS); and
- Abolish the anti-detriment deduction provision.

Again, the proposed commencement date for these changes is 1 July 2017, with the exception of the 5 year unused concessional contribution cap catch up mechanism, which the Government recently announced would be deferred to 1 July 2018.

A high-level summary of this tranche of changes is contained in Table 1 in this Tax Alert, along with EY’s initial comments, particularly around practical implications for Funds and members.

Our overall superannuation ‘scorecard’ summary of the proposed changes is at Table 2.
Other observations

In a welcome response to EY’s submission on the first tranche of changes the Treasury website that contains the new ED materials now states that:

“The draft explanatory material released with the exposure draft legislation deals with the implementation of these specific measures. The final Explanatory Memorandum that will accompany the Bill will provide the overarching policy context and will include a Statement of Compatibility with the new objective of superannuation.”

Given that one of the proposed subsidiary objectives of the superannuation system is for it to “...be simple, efficient and provide safeguards...” it will be interesting to see how this is balanced against the other subsidiary objectives in the context of this tranche of changes.

The length and content of the ED materials suggests that some of these measures will add to the existing complexity and administrative difficulty within the system, although this may be a necessary consequence in the furtherance of other objectives.

EY participates in October Treasury roundtable consultations

EY participated in Treasury roundtables on 5 and 6 October 2016 in both Sydney and Melbourne to discuss the superannuation reform package with selected industry stakeholders.

At these sessions, Treasury was particularly interested in receiving feedback, to better understand the practical implications and unintended consequences that may arise from the proposed design of these rules, along with possible alternative approaches which still achieve the desired policy outcomes. We will continue to liaise with Treasury throughout the consultation process to support their development of the reform package, including via our submissions.

The Government has also confirmed that ED materials on the remaining measures will be released in the coming weeks. Of most interest is the new annual non-concessional contribution cap of $100,000 (which was originally announced as a $500,000 lifetime limit but was recently revised).

Finally, the Government has stated it remains on track to have final legislation for these measures introduced into Parliament before the end of the calendar year.

Action required

Now that the bulk of the detail on the design of the proposed changes has been released, funds, administrators and custodians are in a position to undertake a meaningful assessment of their impact on current operations, particularly on systems and processes, and potential adjustment of offerings.

In addition to participating in the consultation process on these reforms, you should be considering your project plan to implement the changes by the commencement date of 1 July 2017.

This includes impacts on:

- Member communications programs in the near term and when the changes are eventually implemented
- Software
- Processes and systems
- Constituent documents, including rules and policies, of relevant entities.

Where project plans will involve external service providers, you should be contacting them to understand their approach to assessing and implementing the new rules.

EY would be pleased to assist you in any aspect of this process.
Table 1 – Summary of changes in Tranche 2

<table>
<thead>
<tr>
<th>Reform Measure</th>
<th>Key Points</th>
<th>EY Comment</th>
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<tbody>
<tr>
<td>Introducing a $1.6 million pension account transfer balance cap</td>
<td>➤ Individuals will have a “transfer balance account”&lt;br➤ Transfers from accumulation to pension phase are “credited”&lt;br➤ Account can also be “debited” in certain circumstances, such as for commutations and other specified events including structured settlements and family law payment splits&lt;br➤ If the $1.6 million cap is exceeded, then the ATO may issue an excess transfer balance determination notifying of the amount (including notional earnings) which needs to be commuted or withdrawn&lt;br➤ The notional earnings are assessed to the individual, at the tax rate of 15% (increasing to 30% for excess transfers in later years)&lt;br➤ If the value of the pension account grows above $1.6 million due to investment gains, this is not a breach of the cap as those gains do not give rise to a “credit”&lt;br➤ Income stream death benefits to children up to age 25 will generally not count towards their own lifetime cap&lt;br➤ Transitional rules will provide Capital Gains Tax (CGT) relief for Funds who reallocate assets from pension phase to accumulation phase before 1 July 2017</td>
<td>➤ Significant notification requirements for the ATO to track individual transfer balance account credits and debits, and then deal with cap breaches&lt;br➤ Large Funds will be subject to additional administration to support the ATO’s record keeping&lt;br➤ Indexation rules for an individual’s personal transfer balance cap are complex&lt;br➤ The concept of replenishment events such as for losses from fraud is welcome, but it does not include general investment losses such as a market crash&lt;br➤ By allowing for a “debit” for commutations, the transfer balance account rules do not discourage lump sum withdrawals from the superannuation system&lt;br➤ Significant planning will be required for individuals who have more than $1.6 million in pension phase in the lead up to 1 July 2017&lt;br➤ Funds (including both SMSFs and even large Funds) should also consider their own planning opportunities which arise from having pension members, particularly due to the transitional CGT relief</td>
</tr>
<tr>
<td>Valuation of interests in defined benefit (DB) schemes</td>
<td>➤ For the purposes of the $1.6 million transfer balance cap and also for the catch-up concessional contributions mechanism (below), it is necessary to value any interests an individual has in a DB scheme&lt;br➤ “Lifetime” pensions / annuities will be valued by multiplying the annual income entitlement by a factor of 16 (being $1.6 million divided by $100,000)&lt;br➤ “Term” pensions / annuities will be valued by multiplying annual income entitlement by the number of remaining years</td>
<td>➤ A DB member’s annual entitlement only looks ahead 12 months, so unless they are in (or about to be in) drawdown phase then their DB interest will not receive any value&lt;br➤ This provides DB members with a clear advantage when planning opportunities for separate accumulation accounts&lt;br➤ The draft materials acknowledge difficulties around these valuation rules and invite comments on how they might be better addressed</td>
</tr>
<tr>
<td>Limiting the concessional tax treatment for defined benefit income streams above $100,000</td>
<td>➤ For members of untaxed DB schemes (Constitutionally Protected Funds and certain Public Sector Schemes), the current 10% tax offset for recipients aged 60 years plus will only apply to the first $100,000 of DB income&lt;br➤ For other DB scheme members, half of the DB income above $100,000 will be included in assessable income and taxed at marginal rates&lt;br➤ The $100,000 threshold will be indexed in line with the $1.6 million transfer balance cap (divided by 16)</td>
<td>➤ The correlation between the defined benefit income cap of $100,000 and the transfer balance cap of $1.6 million is not explained other than “…to provide a simple valuation rule based on actuarial considerations…”&lt;br➤ Whilst a measure which seeks to equate these caps on an ongoing basis by reference to prevailing investment returns might be preferred from an equity perspective, this would not provide certainty</td>
</tr>
</tbody>
</table>
| Reducing the concessional contribution cap to $25,000 (from $30,000 / $35,000) | ▶ The new cap will apply to all individuals, irrespective of age  
▶ Indexation will be in $2,500 increments  
▶ The Superannuation Guarantee (SG) rules to be amended to ensure that mandatory employer contributions cannot be required which by themselves exceed the reduced concessional cap  
▶ Contributions to Constitutionally Protected Funds (CPF) and untaxed DB schemes will count towards the cap, but also cannot themselves give rise to an excess | ▶ The move to more frequent $2,500 increases is welcome  
▶ We await details on how this cap will tie into the new $100,000 annual non-concessional contributions cap (4 times?)  
▶ Amending the SG rules is common sense, but still does not address the issue for an individual with multiple employers  
▶ Counting CPF and other DB contribution amounts provides a more level playing field  
▶ Previous experience from years when contributions caps have changed suggests that Funds should be prepared to deal with the administrative consequences of increased breaches of the lower cap |
| Reducing the threshold for an additional 15% tax on concessional contributions to $250,000 (from $300,000) | ▶ The amendments do not change the method for calculating these amounts other than the change to the level of the threshold | ▶ Whilst the Government stated in the Budget that “…this change will only affect around one per cent of superannuation fund members”, some Funds will be more impacted than others subject to their member profile  
▶ Again, Funds will be subject to an increased administrative burden |
| Introducing a 5 year catch up mechanism for unused concessional contributions cap amounts, for individuals with superannuation balances of less than $500,000 | ▶ Unused cap amounts (i.e. the difference between actual concessional contributions and the new $25,000 cap) from each year effectively form part of an increased cap in the following year and another 4 years after that (so 5 in total), until they are used up  
▶ They are applied in order, as required, in those 5 subsequent years, if concessional contributions exceed $25,000  
▶ This is subject to the requirement that the individual’s “total superannuation balance” must be less than $500,000 on 30 June of the previous financial year  
▶ An example in the ED materials confirms that it does not matter that the increased concessional contribution would cause the superannuation account balance to exceed $500,000  
▶ The start date for this measure was recently deferred to 1 July 2018, meaning that the first year in which an unused cap amount could be accessed is 2019/20 | ▶ It does not appear that the $500,000 eligibility threshold for this measure will be indexed e.g. it could be based on the concessional contributions cap multiplied by 20, so when that goes up to $27,500 the $500,000 would automatically increase to $550,000  
▶ Whilst Funds will not be responsible for tracking their members’ unused cap amount or “total superannuation balance”, if this task falls on members then the risk of error would be high given these are complex concepts  
▶ The ATO would seemingly have the necessary information to be able to validate members’ ability to access this measure, however this is not currently incorporated into the design of the rules |
| Encouraging the development of innovative retirement income products, and extending the exemption for income from assets supporting income streams | ▶ The income tax exemption to be extended to assets supporting income streams in “retirement phase”  
▶ This to include certain deferred income products such as guaranteed annuities and group self-annuities, although the precise design of those needs to be drafted in amendments to the SIS regime | ▶ More details will follow in due course around the proposed amendments to the SIS rules to accommodate these deferred income products  
▶ This measure might result in financial planning strategies for members who have reached age 65 but continue working, whereby their balance and any further contributions can be immediately used to acquire deferred income products to access the “retirement phase” exemption |
Restricting the tax benefits for Transition to Retirement Income Streams ("TRIS")

- Assets supporting TRIS to not be eligible for the pension exemption, because a TRIS will be specifically excluded from being an income stream in “retirement phase”
- The ability to elect for a TRIS to be taxed as a lump sum benefit (and as such, be tax free up to the “low rate cap” of $195,000) to be removed
- We would expect that the vast majority of TRISs shall cease before 1 July 2017 in light of these changes
- As such, this will impact on the exempt pension income profile for large Funds, even for the current year ending 30 June 2017
- For small APRA Funds and SMSFs, the ability to use the segregation method may be restricted into the future, which will increase costs where they need to obtain an actuarial certificate to claim a proportional “retirement phase” tax exemption
- Funds will also incur administrative costs in processing the conversion of TRISs back to accumulation phase

Abolishing the anti-detriment deduction provision

- Deduction will not be available for members who die from 1 July 2017
- Will also not be available if the anti-detriment payment is not made before 1 July 2019
- The original announcement did not refer to the 1 July 2017 commencement as being based on the date of death, so this clarification is welcome
- A 2 year period for funds to process anti-detriment payments should be adequate

Other administrative changes

- Simplified ATO reporting requirements for funds in relation to defined benefit members with income above $250,000
- ATO can combine legislative notification requirements to taxpayers in a single document
- These are unexpected although welcome changes
- Combining ATO notices applies for all tax purposes, not just in relation to superannuation

Changes apply from 1 July 2017, other than the 5 year catch up mechanism for unused concessional contributions cap amounts, for individuals with superannuation balances of less than $500,000, which commences from 1 July 2018.
Table 2 – Delivery of superannuation changes proposed in the 2016 Budget, as subsequently adjusted (as at October 8, 2016)

<table>
<thead>
<tr>
<th></th>
<th>‘Tranche 1’ ED 7 Sep 2016</th>
<th>‘Tranche 2’ ED 27 Sep 2016</th>
<th>Expected in ‘Tranche 3’</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Objective of superannuation to be enshrined in stand-alone legislation</td>
<td>Y</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Superannuation pension phase - $1.6m transfer balance cap for retirement accounts</td>
<td></td>
<td>Y</td>
<td></td>
<td></td>
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<tr>
<td>• New $100K non-concessional limit, which replaces Budget proposal for Non-concessional contributions $500,000 lifetime cap from Budget night</td>
<td></td>
<td></td>
<td>Y</td>
<td>Announced 15 Sep 2016</td>
</tr>
<tr>
<td>• New $1.6m account balance cap for non-concessional contributions</td>
<td></td>
<td></td>
<td>Y</td>
<td></td>
</tr>
<tr>
<td>• Concessional contributions cap cut to $25,000 from 1 July 2017</td>
<td></td>
<td>Y</td>
<td></td>
<td></td>
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<tr>
<td>• Superannuation contributions tax (extra 15%) for incomes $250,001+</td>
<td></td>
<td></td>
<td>Y</td>
<td></td>
</tr>
<tr>
<td>• Concessional contributions catch-up for account balances less than $500,000</td>
<td></td>
<td></td>
<td>Y</td>
<td></td>
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<tr>
<td>• Tax deductions for personal super contributions extended</td>
<td>Y</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>• Transition to retirement pensions - tax concessions to be reduced</td>
<td></td>
<td></td>
<td>Y</td>
<td></td>
</tr>
<tr>
<td>• Superannuation contribution rules – proposed removal of work for age 65 to 74 – This proposal has now been abandoned</td>
<td></td>
<td></td>
<td></td>
<td>Announced 15 Sep 2016</td>
</tr>
<tr>
<td>• Low income super tax offset (LISTO) to be introduced</td>
<td>Y</td>
<td></td>
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<td>• Low income spouse super tax offset to be extended</td>
<td></td>
<td>Y</td>
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<tr>
<td>• Retirement income products - tax exemption extended</td>
<td></td>
<td></td>
<td>Y</td>
<td></td>
</tr>
<tr>
<td>• Anti-detriment deduction to be removed for super death benefits</td>
<td></td>
<td></td>
<td>Y</td>
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</tbody>
</table>
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