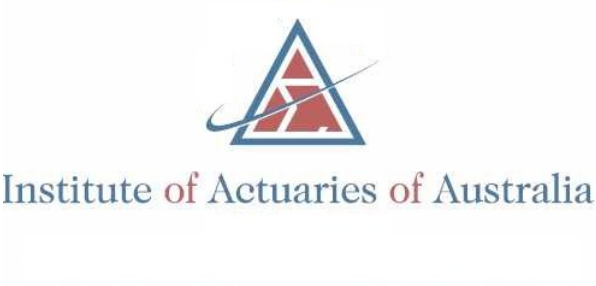

5 November 2003

Mr Nigel Murray
Manager, Superannuation, Retirement & Savings Division
Department of the Treasury
Langton Crescent
PARKES ACT 2600
AUSTRALIA

Dear Mr Murray

DRAFT SUPERANNUATION SPLITTING REGULATIONS

The Institute of Actuaries of Australia ("the Institute") welcomes this opportunity to comment on the draft regulations regarding the splitting of superannuation contributions.

We support the Government's policy of broadening the accessibility of superannuation to individuals outside the workforce, enabling low income earners or non-working spouses to have their own superannuation and ensuring that single income families have access to two Low Rate Thresholds and two Reasonable Benefit Limits, as do dual income families.

We have recently written to the Senate Economics Legislation Committee expressing our concerns about the manner of implementing these initiatives through the mechanism of contribution splitting, as provided for under the Taxation Laws Amendments (Superannuation Contributions Splitting) Bill (referred to below as "the Bill"). We remain of the view that the benefit splitting option would be a far more economical and practical model which would facilitate cost-effective access to splitting by lower and middle income families.

In this submission, we will not repeat the concerns that we expressed in that earlier letter. Instead we concentrate on the details in the draft regulations, on the basis that the Government will proceed to legislate for a contribution splitting approach.

The draft regulations on which we are providing comments are the *Income Tax Amendment Regulations 2003 (No.) ("ITAR")* and the *Superannuation Industry (Supervision) Amendment Regulations (No.) 2003 ("SISAR").* Our comments relate mainly to the latter draft regulations.

The Institute of Actuaries of Australia
ABN 69 000 423 656

Level 7 Challis House 4 Martin Place
Sydney NSW Australia 2000
Telephone 02 9233 3466 Facsimile 02 9233 3446
Email: insact@actuaries.asn.au Web site: www.actuaries.asn.au

Reduction in accrued benefits

SIS Regulation 13.16 states that a member's accrued benefits "must not be altered adversely to the beneficiary…by any (other) act carried out, or consented to, by the trustee of the fund".

Contribution splitting will reduce a member's accrued benefits. Since the splitting relates to contributions in the previous financial year, the reduction will be retrospective in nature. This will contravene Regulation 13.16.

We recommend that the Government amend Regulation 13.16 so as to permit a reduction in the value of a member's accrued benefit due to the trustee giving effect to a contribution splitting application.

We note that Regulation 13.16 was amended in this fashion to cater for the payment splitting provisions under the *Family Law Act.*

Restriction to accumulation interests

Draft SISAR 6.40 provides that the spouse contribution splitting provisions apply to members who hold only an accumulation interest in a fund. "Accumulation interest" is defined in SIS Regulation 1.03 as "a superannuation interest that is not a defined benefit interest". The definition of "defined benefit interest" is found in SIS Regulation 1.03 AA.

Under the draft SISAR, the following persons will be unable to split contributions:

- All members of unfunded public sector superannuation schemes that have at least one defined benefit member; and

- For other defined benefit schemes: members who have defined benefits (except for members whose defined benefits apply only on death or disablement).

In other words, members of defined benefit schemes who have entitlements made up of both defined benefit and accumulation components will not be able to split contributions.

In principle, the Institute would prefer that defined benefit members not be excluded from the contribution splitting provisions. We consider it would be reasonably straightforward to extend the contribution splitting provisions to the accumulation interests of defined benefit members.

However we recognise that there are significant practical issues to be addressed if they were to extend to defined benefit interests and, for this reason, we suggest that trustees of funds be allowed to offer contribution splitting in respect of defined benefit interests on a voluntary basis.

We note that defined benefit interests are already subject to "splitting" under the Family Law benefit splitting requirements and effectively a similar process is required to cater for the contribution surcharge provisions. In such instances, trustees are required to reduce the value of the defined benefit interest and commonly do so by establishing an "offset accumulation account".

Splitting of contributions made in respect of defined benefit interests could be administered in a similar fashion.

One practical issue is that the amount of the contribution split is proposed to be determined by reference to the amount of deductible and undeducted contributions received by the fund in respect of the member in the previous financial year. Actual employer contributions in respect of defined benefits are not determined by reference to an individual member. A mechanism would therefore be required to determine the amount of the "deductible" contributions in respect of defined benefit interests for the purpose of the contribution split. The notional surchargeable contribution amount would be a possible approach, but this would require further consideration. We suggest that the trustee of the fund could consider the actuary's advice in this regard as part of its decision to voluntarily "opt in" to contribution splitting.

Even if contribution splitting is not extended to defined benefit members, we note that a defined benefit member may leave service and retain the benefit in the fund as an accumulation interest. This person could apply to split their previous year's contributions under the draft Regulations as they stand. However for the reasons discussed above it is not clear from the Regulations how the deductible contributions for that person in the previous year are to be determined. We suggest that the draft Regulations are amended to either exclude members with such previous defined benefit interests or to allow the trustee to include them under the "opt in" power for defined benefit interests proposed above.

Allocations from surplus

In some funds (including both defined benefit funds and accumulation only funds), surplus is used to provide allocations to members' accounts, in lieu of employer contribution payments to the fund. The draft Regulations appear to exclude splitting of such allocations, thereby placing members of such funds at a disadvantage to members of funds for whom contributions are physically paid to the fund.

We recommend that the draft Regulations be amended to allow splitting of contributions met by allocations from surplus.

Trustee's decision on an application

If a member's application for contribution splitting meets certain criteria, the trustee is required to give effect to the member's request; the trustee does not have discretion to decline the member's application.

No discretion for trustee to decline application

Under draft SISAR 6.43, a member may apply in writing to the trustee of his/her fund for contribution splitting with the member's spouse. Other than in the circumstance we mention below, if the application meets the requirements set out in SISAR 6.43, as well as requirements (a) through (f) of draft SISAR 6.44(1), the trustee is required to accept the application.

Failure by the trustee to accept and implement the application is a breach of the operational standards under the SIS Act. There are penalties on trustees for breaching an operational standard. The fund may also be declared non-complying. Therefore trustees will be forced to implement the member's request.

There is only one limited instance where the trustee may decline the application. That is where the member applies for the contributions to be split to a spouse account in the same fund and the trustee has determined not to establish such accounts.

However, in such a case the member can simply re-apply for the contributions to split to another fund. A trustee may not decline a member's request for an amount to be transferred out of the fund to another regulated superannuation fund, approved deposit fund, EPSSS or RSA.

For the reasons discussed below, we recommend that the draft SISAR be amended to provide discretion to trustees to decline an application for contribution splitting in a wider range of circumstances.

No discretion for trustee to adjust amount of contribution split applied for

Further, under the draft SISAR, the trustee is obliged to pay the amount requested by the member to the other fund; there is no discretion for the trustee to determine a lesser amount.

The maximum amount that the member may apply to split to the spouse interest is the sum of:

(a) 70% of the amount of deductible contributions; and
(b) 100% of the amount of the undeducted contributions

received by the trustee in respect of the member in the previous financial year.

The Explanatory Material to the SISAR states that the "amount relating to deducted contributions is limited to 70% to facilitate administration (for example, this will ensure that there are sufficient funds left in the member's account to pay any surcharge liability)."

The 70% limit appears to have overlooked the fact that a member's account in a fund may be subject to deductions to cover the following items (in addition to the 15% contributions tax on deductible contributions and the surcharge contributions tax on higher income earners):

(i) investment losses;

(ii) expenses of operating the fund;
(iii) premiums for death and disability insurance cover;
(iv) payments of benefits (eg where a member is over age 65 and requests a payment of part of the account in the fund) ;and
(v) benefit splitting under the *Family Law Act*.

The total of these deductions/adjustments can quite easily exceed 30% of the deductible contributions to the member's account, particularly in a year where the fund experiences investment losses.

The portability requirements create another possible cause for similar problems. An "inactive" member could transfer most of his/her benefit out of the fund under the portability rules and could then apply for the contributions for previous year to be split (even though they have already been paid out).

We also note that a court may order a member to apply for contribution splitting, thereby giving effect to continual splitting of matrimonial interests for maintenance purposes. This may not be an intended consequence of the legislation.

The draft SISAR also ignore the fact that the contributions received may be subject to vesting provisions.

For the above reasons, we recommend that the draft SISAR provide reasonable discretion to trustees to limit the amount of contributions to be split at any time – for example, if the remaining benefit would be less than the $5,000 limit which applies under the new portability provisions. Alternatively, trustees could have the discretion to decline a member's request for contribution splitting in specified circumstances.

Liability for Surcharge

The draft SISAR requires the surcharge liability in respect of the contributions that are split to remain with the trustee of the member in respect of whom the contributions were paid, if that trustee continues to hold any contributions for the member. Contribution splitting, together with the other deductions to a member's account that we have mentioned, can leave the member's interest without sufficient balance to pay a surcharge assessment. Such assessments can be received some time after the trustee has received the contributions that are the subject of the assessment. In the meantime, the contributions may have already been split and paid out of the fund and the remaining balance in the member's account may have been further reduced by the above factors.

Therefore even if the trustee holds an account balance of only $1 for the member, it will continue to be liable for surchargeable contributions in respect of the member. This liability could potentially be several thousand dollars.

The Institute strongly recommends that amendments are made to overcome this very significant problem. One possibility would to provide for the liability to transfer to the member if the fund benefit is insufficient to pay the assessment.

Public offer provisions

The Institute considers that the amendments to Regulation 3.01 do not achieve the Government's intention to prevent a fund becoming a public offer fund. As the draft regulation stands, once the member spouse leaves the fund, the continuation of the spouse as a member will mean the fund becomes a public offer fund.

There is a similar problem already existing for spouse members following a Family Law benefit split. The proposed Regulations provide an opportunity to address this related matter.

Condition of Release Requirements

The Institute considers that the requirement in the draft SISAR for the member to specify that the non-member spouse has not satisfied a condition of release is unworkable, on the basis that:

- it requires one person to make such a statement in respect of another person;
- members will not understand the complexities of the conditions of release; and
- the conditions of release (other than death or attaining age 65) do not make sense in this context.

For example, to satisfy a condition of release on retirement between the ages of 55 and 60, the person must have left employment (this could be many years ago) and the trustee must be reasonably satisfied that the person will never work again. Which trustee needs to be so satisfied? The spouse may not be a member of any fund. The Institute questions whether the Government intends that the trustee of the member's fund will need to make such an assessment? If so, the trustee will incur additional costs in doing so.

Similarly, to satisfy the condition of release relating to permanent incapacity also requires a trustee decision. Again, which trustee will decide this in relation to the member's spouse?

We suggest that the references to conditions of release be removed from the draft Regulations and that they be replaced with clear statements that are relevant to the situation.

Drafting

There are a number of areas in the draft SISAR which require attention to improve the wording.

1. We believe draft Regulation 6.43 should be revised to clarify what is and is not allowable in regard to the amounts of deductible contributions and undeducted contributions which can be split. For example:

- draft Regulation 6.43 parts (1) and (2) could be taken to mean that the only amounts that a member can apply to split are 100% of deductible contributions, 100% of undeducted contributions and 100% of both, ie, there is no clear power for the member to request that a lower amount be split;

- draft Regulation 6.43(2) also appears to specify that the member can apply to transfer an amount equal to 100% of deductible contributions, the footnote states that the member cannot transfer more than 70% and 6.44(1)(b) may or may not allow this depending on whether the member has sufficient undeducted contributions not being split.

We suggest that instead of stating in draft Regulation 6.43(1) that a member can apply to split "an amount of benefits… that is equal to an amount of the contributions …", the Regulation state that a member can apply to split "an amount of benefits, for the benefit of the member's spouse, that does not exceed the amount set out in subregulation (2)(b)".

Draft Regulation 6.43(2)(b) should then be altered to read:

"(b) state the amount that the applicant wishes to roll over, transfer or allot for the benefit of the member's spouse. The amount stated may not exceed the sum of:

(i) in respect of the deductible contributions received by the trustee for the applicant for the previous financial year, 70% of such contributions, and
(ii) in respect of the undeducted contributions received by the trustee for the applicant for the previous financial year, 100% of such contributions; and"

2. Regulation 6.44(1)(b) is unclear as it currently stands. It can be read as referring to 70% of any deductible contributions (not only those in the previous year). The restriction to previous year only applies to the undeducted contributions.

Further, this Regulation specifies the maximum amount of the split as the sum of the deductible and undeducted components. This leaves scope for a member to apply to split more than 70% of the deductible component.

Example: A member has deductible contributions of $2,000 and undeducted contributions of $1,000. The intended limit on the split is $2,400 (70% of $2,000 plus 100% of $1,000). The wording of the draft Regulation would allow a split of 100% of the deductible contributions and up to 40% of the undeducted contributions.

If this is unintended – or if funds are to be required to administer the split in accordance with the member's directions as to each type of contributions - then this Regulation and Regulation 6.43 should be amended to refer to the limits on the separate types of contribution.

3. The draft Regulations are not clear as to what happens if a member has more than one spouse. The Bill provides for a maximum of one split per year but this could be interpreted as per spouse. The potential for a member to split contributions to both spouses, accessing the 70% and 100% limits each time, can again result in the balance in the member's account being fully drawn down.

4. The draft Regulations allow the trustee to accept only one application in a year. We see no reason why a trustee could not accept, on a voluntary basis, more than one request per year.

5. Regulation 6.43(1) requires the application to be made after the end of the financial year in which the contributions to be split are made. We see no reason why the member could not make the application before the financial year end. The trustee would still consider and, if required, give effect to the application, within the Government's intended timing.

6. As drafted, the Regulations prevent members who exit during the financial year from making an application to split their contributions. We suggest that the Government consider a voluntary arrangement which would allow a member to make an application before the end of the year – and for the trustee to consider (and give effect to) that application at benefit payment time. A "contribution splitting flag" arrangement (similar to the flagging arrangements under the Family Law provisions) could apply in such cases to ensure that the application is considered before the benefit payment is made.

Summary

- We recommend that the Government amend Regulation 13.16 to allow a reduction in the value of a member's accrued benefit due to the trustee giving effect to a contribution splitting application.

- We consider that defined benefit members could be brought within the contribution splitting provisions, at least for their accumulation interests but preferably also for their defined benefit interests on a voluntary "opt in" basis at the discretion of the trustee of the fund.

- We recommend that the Regulations be amended to allow splitting of contributions to members' accounts made from allocations of surplus in the fund.

- We recommend that the draft SISAR provide discretion to trustees to limit in reasonable circumstances the amount of contributions to be split (or to decline a member's request to split).

- We strongly recommend that amendments are made to overcome the problem that arises from the requirement that the liability for surcharge remains with the trustee of the member's fund.

- We recommend that the references to conditions of release be removed from the draft Regulations and that they be replaced with clear statements that are relevant to the situation.

- There are a number of areas where the wording of the Regulations needs attention to improve clarity, give effect to the Government's intentions and to address particular issues.

The Institute would be pleased to assist further with the development of the draft Regulations.

We would be pleased to discuss the issues raised in this submission. Should you wish to discuss this further, please contact Vicki Mullen, IAAust Manager, Policy & Public Relations on tel. no. (02) 9239-6111 or email: vicki.mullen@actuaries.asn.au.

Yours sincerely

Chris Lewis
President