Submission to

Senate Economics Committee

Inquiry into

Taxation Laws Amendment (Superannuation Contributions Splitting) Bill 2003

by

The Association of Superannuation Funds of Australia Ltd

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Federal Secretariat

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1. Introduction

ASFA is a non-profit, non-party political national organisation whose mission is to protect, promote and advance the interests of Australia's superannuation funds, their trustees and their members. As such it is the "Voice of Super".

ASFA's 600 or so constituent members have been estimated to be responsible for around $420 billion of assets, about 80 per cent of the total superannuation funds under management of $508 billion as at March 2003. ASFA member funds in aggregate also represent around 80 per cent of Australians with superannuation.

ASFA's interest in the superannuation contributions splitting proposal flows from the implications of this for both members with and without a spouse, and for the administrative costs of funds. It will be important for any splitting of contributions mechanism to be as cost efficient as possible in order to maximise benefits for members who split their contributions and for their spouses. It is also important for any costs associated with contribution splitting to be borne by those directly involved in the contribution splitting rather than superannuation fund members more generally.

2. The legislative proposal

The *Taxation Laws (Superannuation Contributions Splitting) Bill 2003* does not of itself seek to allow the splitting of contributions. This Bill deals with consequential amendments related to proposed changes to the regulations to the *Superannuation Industry Supervision Act 1993.* The Bill also proposes amendments to the *Income tax Assessment Act 1936,* to ensure that appropriate taxation status is given to a split contribution when it is rolled over to another account and/or fund, and to the *Superannuation Contributions Tax (Assessment and Collection) Act 1997,* to ensure that any surcharge liability attached to the original contribution is unaffected by the split. Amendments of the type proposed in the Bill being considered by the Committee would be required to support splitting regardless of which specific splitting option is adopted by the Government.

The Government also released on 13 October, after this current reference to the Committee, draft amendments to the Superannuation Industry (Supervision) regulations, Retirement Savings Account regulations and taxation regulations. Comments on these regulations will be taken by the Treasury up until 31 October, and ASFA will be making a submission to Treasury.

ASFA's analysis of the specific Bill being considered by the Committee indicates that its provisions will make the changes to general taxation arrangements that will be necessary to support splitting. However, there is the question of which method of splitting would be most appropriate, with the material supporting the Bill indicating the

Government's current preference and the advantages and disadvantages of alternative methods. The Explanatory Memorandum states, in relation to the splitting proposal, that:

> The Government is proposing an 'annual split' model for the splitting of contributions. That is, after the end of the financial year the member could request that contributions made in the previous year be split with their spouse.
>
> The exact details of how this will operate will be specified in amendments to the Superannuation Industry (Supervision) regulations, Retirement Savings Account regulations and taxation regulations. Where a split of contributions is made in accordance with those regulations then the tax consequences will be as set out in this Bill.

In evaluating the implications of the proposal for superannuation funds and their members, the associated regulatory amendments will be very important. ASFA assumes, on the basis of the draft regulations that have been circulated for comment by the Government, that:

- The regulations will only permit annual splitting of the previous year's contributions. The regulations would apply from 1 July 2004, but would only be mandatory on funds in respect of requests received on or after 1 July 2005. It would be optional for trustees to give effect to an otherwise valid request before 1 July 2005.

- An otherwise valid request to split made before 1 April in the financial year following the year of contribution must be processed by a fund, and a fund may choose to process a request received between 1 April and 30 June.

- The 'splitting' is limited to married and 'de facto' couples, and does not apply to same sex couples.

- Any surcharge obligation is the responsibility of the member making the split.

- The maximum percentage of deductible contributions that can form a split to the spouse will be limited to 70% in order to ensure that any surcharge obligation is met. Given that no surcharge considerations apply to personal, undeducted contributions, the maximum split of such contributions could be 100%.

- A trustee may refuse an application to split contributions if the applicant would become a protected member as a result of splitting the contributions.

- A trustee will have 90 days following receipt of a valid application to create an interest in the fund for the receiving spouse or to rollover the specified amount, depending on which option is specified.

- The proposal does not extend to a defined benefit interest, or to a member of a defined benefit fund who holds both an accumulation and a defined benefit interest in that fund.

Such a proposal for annual splitting of contributions would require considerable changes to how funds undertake administration of accounts. Specific set up costs would include those related to:

- Amending trust deeds.
- Communicating to members.
- Designing a new form for members applying to split contributions which will obtain all necessary information.
- For those funds permitting a receiving spouse to become a member in order to receive a split contribution, putting in place arrangements to forward a Product Disclosure Statement and application form to the receiving spouse and ensuring that a completed application form is received before an interest is issued.
- Amending systems to generate appropriate rate of contributions and process an Eligible Termination Payment (ETP).
- Recording and maintaining new data items such as:
  - whether or not the account is a contribution split account,
  - receiving spouse account fund name,
  - receiving spouse account number,
  - percentage split,
  - contribution type split,
  - contribution split cancellation indicator.
- Implementing a new process for "rollover" of the split amount to an internal or external Fund spouse account.
- Processing a payment and a "rollover" form for each external transfer.
- Designing a new "rollover" transaction for each account (member and receiving spouse) and ensuring these can be recognised by other system processes and for annual member statement purposes.
- Considering the creation of one or perhaps two new fee types to cover/recover costs.
- Putting in place arrangements to notify a member in writing if their application is refused.
- Reviewing and, if needed, modifying forms (new), literature, letters, website, procedures, and staff training.

The list above is not exhaustive. Although each action may appear in itself to be a relatively minor consideration, each requires considerable analysis, time and cost and the sum of all changes constitutes major modification to computer systems and work practices. Also it is important to note that initial set-up costs are likely to borne by all fund members, not just those who later choose to use the provisions.

All funds consulted by ASFA see some difficulties and costs in implementation. Superannuation funds with legacy administration systems, while preferring this proposal to earlier Government proposals on splitting, advise that legacy administration systems are difficult and costly to modify.

Given that the explanatory memorandum opens up the issue of the most appropriate splitting mechanism, this submission will address the question of which splitting mechanism should be specified in the yet to be promulgated regulations.

3. Aim of the proposal

In addressing questions of equity ASFA believes the Government's proposal should be tested against the following objectives:

- Provide fairer outcomes especially where there have been broken paid work patterns for one or both spouses.

- Allow both spouses to maximise retirement savings.

- From the consumers' perspective, be "simple" and allow an appropriate degree of control.

In terms of fairer outcomes and maximising retirement savings, currently individuals in a dual income family are separately assessed for Reasonable Benefit Limit (RBL) and low rate tax threshold purposes when they access their superannuation benefits on retirement. This gives families where each spouse is in paid employment and receiving the benefit of employer or otherwise tax deductible superannuation contributions a potential significant financial advantage over single income families with the same total retirement benefits. While currently only a small minority of individuals have retirement benefits above the low rate threshold and an even small number exceed their RBL, the numbers of such individuals will increase with maturity of the compulsory superannuation system.

The Government proposal addresses this relative disadvantage suffered by single income families by permitting the paid income earner in the family to split their superannuation contributions thereby providing access to two Eligible Termination Payment (ETP) low rate thresholds and two Reasonable Benefit Limits (RBLs).

The most effective outcome may, however, involve some trade-offs of objectives. ASFA believes that a better result, in terms of overall maximising retirement savings, equitable distribution of assets, cost effectiveness and simplicity could be achieved by permitting the splitting of superannuation benefits at the point of retirement of either spouse. This option does not immediately enable the non-working spouse to have control over superannuation assets to the same extent as contribution splitting, but it

achieves the other objectives to a greater degree and ultimately gives the non-working spouse a larger retirement amount and greater flexibility and control of savings in the retirement phase.

ASFA acknowledges that budget constraints make it necessary to restrict the splitting to benefits accumulated after a specific date. We have previously provided to the government a simple method for apportioning contributions received before and after 1 July 2003. This method would not impose any new record keeping obligations on funds.

4. Likely impact of the government proposal

The proposal as currently formulated by the government is likely to have a range of impacts on member behaviour, fund administration procedures, and fees charged to those involved in contribution splitting and to members more generally. This section of the submission explores those implications in order to assist the Committee in determining what would be the optimal design for the measure in terms of meeting the objectives which have been set.

The comments below are based on the assumption, consistent with the draft regulations and the comments in the explanatory memorandum, that the Government's favoured approach is to allow members to split contributions on an annual basis in regard to the contributions made in the preceding financial year.

Impact of proposal on member behavior

Early response from ASFA members to the concept of splitting contributions on an annual basis in order to gain two low rate thresholds and two RBLs suggests that it would be of most interest to fund members who are currently married (legal or de facto) and approaching retirement. However, our members indicate that there would likely to be a low take-up rate by younger couples, at least initially and perhaps on a continuing basis. The disparity in superannuation entitlements tends to be less for younger workers, particularly for couples who do not yet have children.

The experience of funds also suggests that it is people toward the end of their work career rather than at the beginning that actively plan and supplement their retirement income savings. A low take up by younger couples would significantly reduce the value of the currently proposed options given that it would only be used by a relatively small number of couples and then only for a relatively small number of years close to retirement. Splitting at the contribution stage rather than the benefit stage also rules out persons who are in defined benefit funds from making use of the splitting mechanism.

Impact of proposals on administration costs
The process described in Section 2 above could be reasonably described as being relatively complex, and ASFA is concerned that this complexity of operation has the

potential to lead to increased administration costs and fees to participants which would seriously undermine the potential financial gains. Whilst there has been insufficient time to exactly quantify the impact on administration costs, ASFA has undertaken a brief analysis of the potential changes to administration processes that would be required. The extensive changes required suggest that both set up and ongoing costs would not be insignificant.

This was acknowledged in the options paper circulated by the government, which noted that the cost to taxation revenue of the proposals would come in part from increased taxation deductions for administration expenses ($11 million). This implies total additional administration costs to funds over three years of more than $70 million. Increased administration costs have a direct impact on member account balances.

Aggregate costs of this order are plausible given the costs of altering administration systems and additional ongoing costs if splitting of contributions on an annual basis were adopted. However, this would lead to the measure being relatively inefficient in terms of the additional costs incurred relative to the benefits delivered. Set-up costs would have to be borne by all members and ongoing transaction and account costs would be borne by the around 26,000 couples a year that Treasury estimates will make use of the measure.

Impact of administration costs on account balances

Apart from the costs to funds directly associated with introducing the measure, there would be the cost for specific couples in running two accounts. A single income family would be required to hold a minimum of two accounts, thus potentially doubling current administration charges the family currently incurs. However, if the spouse already has an account which can be used as a vehicle for the split contributions, this cost may be reduced.

For a couple where the primary income is on average weekly earnings ($45,000 a year) and the secondary income earner has no superannuation, the main benefits of splitting would come from access to two low rate thresholds, with the rate being zero for a payment from a taxed fund to a person aged over 55. An RBL problem is an unaffordable luxury for a person on average earnings.

Assuming salary growth of 3.75%, investment earnings of 7% and an entry fee of 4% to a retail public offer fund, an individual on AWE would after 30 years, and in today's dollars, accumulate a lump sum of $160,647 and pay lump sum tax of $7,960 if the benefit were taken as a lump sum. No lump sum tax would eventually be payable if all contributions were split evenly along the way, but there would be additional costs that would exceed the tax saving. Assuming that the spouse account attracted a $52 a year administration fee, the total impact of direct administration fees for the spouse account would be $2,149 in today's dollars. There would also be additional entry fees totalling $3,347 in today's dollars if charged at 4% of the split contributions.

As well, the fund would make a charge to cover the costs of splitting the employer contributions. If this were $75 a year (as indicated by some funds already) the total cost over 30 years in today's dollars would be $3,099.

The net result (in today's dollars) would be a tax saving of $7,960, outweighed by total additional costs of $8,595.

In contrast, one split at the end would achieve the same tax savings but would incur total costs of $100 or less.

It should be noted that the transfer processing fee amount used in the example reflects the current all-inclusive cost of processing a rollover. The figure does not make allowance for the impact on general fund administration costs (and member account administration fees) arising from the increased complexity and cost of administration arrangements or the cost of developing new administration systems. These systems and start up costs would be significant.

In the above calculations, also no consideration has been given to the potential for reduced long-term investment returns flowing from the requirement for funds to either carry higher cash reserves or liquidate assets in order to fund the account transfers. Some thought should be given as well to the potential for both increased administrative risk and exposure to possible fraud that naturally arises from increased transaction volumes within the system.

If the government were to adopt an up-front split approach (regardless of whether it was on an annual or contribution by contribution basis), there would be a need for an extensive education campaign to provide fund members with the necessary skills and knowledge to determine whether there would be any benefit gained by splitting.

5. Advantages of ASFA proposal to split at the benefit stage

ASFA supports the option to split at the benefit stage, both in order to contain what might otherwise be very substantial administration costs for funds (and therefore members) and to allow couples to exercise splitting at a time when it is clearer that it will be of benefit to them and without a diminution of savings as a result of two lots of account fees. Over time, the proposal would have the capacity to deliver benefits similar to those currently available to divorcing couples entering family court agreements, thus countering the regular criticism that divorcees are 'better off' than people who remain married.

While the explanatory memorandum asserts that splitting at the benefit stage would involve a substantial cost to revenue, no actual estimate is provided. ASFA considers that splitting at the benefit stage would be revenue neutral for a not insignificant number

of years as the revenue costs of any additional splitting would be more than offset by lower tax deductions for administration costs by funds. As well, relatively few individuals have benefits which exceed their RBL (perhaps only a few hundred cases a year in total for married persons), and the number of couples where benefits exceed the tax free threshold is also relatively low.

While the number of such couples where at least one person exceeds the tax free threshold will grow in the future, Treasury projections indicate that even by the year 2010 the average retirement payout will be $97,000 in CPI deflated dollars, with around three-quarters or more of recipients receiving less than that. Given that the tax free threshold for those aged over 55 is already $117,576 and is indexed by the movement in average earnings, only a relatively small proportion of the population would have an incentive to split benefits. The proportion of the population interested and able to split will also be decreased by the incidence of divorce and death of a spouse by retirement age, by some part of the retirement benefit being concessionally taxed under the pre-1983 service arrangement, by certain couples having only a relatively small disparity in benefit levels and/or both being over the threshold, and by all or part of retirement benefits of certain individuals being rolled over into income streams rather than being taken as a cash lump sum. On top of this, only the part of the benefit attributable to post 1 July 2003 service would be able to be split.

Splitting at the benefit stage would not involve any significant tax revenue cost over the forward estimates or indeed for a decade or two if ever. Splitting at the benefit stage might actually be revenue positive over the forward estimates, as there would be lower deductions by funds in regard to administration costs. It is perhaps a little surprising that while describing in a reasonably neutral way the splitting at benefit stage option, no costing is provided by Treasury in the explanatory memorandum.

The explanatory memorandum also asserts that splitting at the contribution stage may provide spouses with improved access to cost-effective death and disability insurance. This is unlikely to be the case in most instances as the most low cost insurance options are group arrangements linked to the member being in the paid labour force. Insurance cover offered by retail superannuation funds to individuals who are not in paid employment is unlikely to be much more cost effective than insurance cover available outside the superannuation environment.

On the other hand, splitting at the time of retirement would be psychologically and financially tuned to adjusting superannuation entitlements. Anecdotal evidence indicates that current spouse accounts are generally only being used for on-going contributions where the contributor can claim a tax deduction. There is an increasingly common practice of members making a lump sum spouse contribution, generally out of their own lump sum payment, when on the cusp of retirement. This practice reflects the view of many Australian families that the most appropriate time to rearrange family finances is at the point of retirement and when all the financial circumstances, and the implication of their actions, are apparent.

The only area where splitting at the benefit stage does not fully meet the objectives of the government is in regard to control of a superannuation account by the spouse receiving the benefit of the split. However, where a couple remains amicably married, which presumably will be the case when a spouse in inclined to split either contributions or a benefit, then the couple could jointly make decisions about how the superannuation of the main income earner is invested. In the case of marriage breakdown the recent amendments to the Family Law provisions relating to superannuation would permit a spouse to have part or all of a superannuation entitlement transferred to them.

In summary, the key advantages of the ASFA proposal to split at the benefit stage are:

- Simplified administration - the split need only be done once.
- Maximisation of benefits - through reduced account administration costs and the split being done at a time approximate to the retirement of a partner and being made in the manner that is most appropriate to their circumstances at that point in time.
- The issues associated with superannuation contributions surcharge would not arise, thus effectively permitting up to 100% of all contributions to be split
- There is the potential to extend the benefit to members with a defined benefit interest. This could be achieved by adopting valuation principles similar to those to be used when valuing an interest for the purposes of family law agreements.
- Couples would be at the best time, both psychologically and financially, to consider their options.

However, if the Government remains inclined to pursue the annual split of contributions in arrears option, the following section provides some comments on the option and on the administration issues involved.

6. Specific ASFA comments on the annual split proposal

Cost to employers

Although the aim of the proposal is to avoid any administrative burden and costs on employers, there are a significant number of employers who currently meet all or part of the administration costs of their sponsored funds. For these employers, introduction of an annual splitting mechanism would result in an increase in employment related costs.

Status of the split contributions account
The issue of whether split deductible contributions, once rolled over to the account of the receiving spouse of the member making the split, are to be treated as mandated contributions and subject to member protection is not dealt with in the Bill or the draft regulations. If they are protected, there is the potential to increase funds' member protection costs (thus affecting all fund members). On the other hand if they are not, then the spouse benefit could be eroded by administration costs. Given that the draft regulations provide that a trustee may refuse an application to split contributions if the applicant is a protected member or would become a protected member as a result of splitting the contributions, ASFA suggests that member protection should not apply to contributions transferred to the receiving spouse.

There would also be disclosure and FSR implications of establishing an account for the receiving spouse which do not appear to be contemplated by the draft regulations. A fund would not be able to simply decide to create a new interest in the fund for the receiving spouse, as seems to implied by draft regulation 6.44(e). The fund would have to first provide the receiving spouse with a Product Disclosure Statement and an application form, and receive a completed application form. If a fund provided advice of some kind to the receiving spouse there also might be a requirement to provide certain documentation in regard to that advice. In addition, in funds which are not public offer, the spouse account would have reporting and other arrangements which may differ from those applying to members who are employer sponsored. These FSR requirements would add another layer of administration to the splitting arrangements, and may discourage funds which are not public offer from offering spouse accounts.

Taxation of death benefits
There may be a requirement for funds to disclose to fund members that Section 279D (the 'anti-detriment') provisions of the Income Tax Assessment Act can only be applied in respect of taxable contributions held in the deceased member's account.

Requirement that receiving spouse has not met a condition of release
The draft regulations require the applicant to declare that the spouse (presumably the receiving spouse) has not satisfied specific conditions of release specified in the regulations. While this places the evidentiary burden on the applicant, it is likely that funds will be asked to explain to members what these conditions of release mean in practice. Funds will also have to ensure that applicants make the appropriate declaration in regard to the specified conditions of release not being satisfied.

Information that funds will have to provide to members
Given that the regulations are silent on this issue, ASFA assumes that superannuation funds will be able to choose the manner in which any information is provided to members about the option to split contributions and on the quantum of contributions that may be split. For instance, some funds may choose to provide such information either explicitly or implicitly as part of the annual 'reporting to members' process while

others may be prepared to provide the information verbally or by electronic means on request. ASFA would oppose any specific regulations on this point as they would have the potential to add unnecessarily to the administration costs of funds.

Information that members will have to provide to funds
While the draft regulations require applicants to provide certain information, including the name of the fund in which the receiving spouse has an account when a rollover is proposed, there may not be sufficient information necessary to give efficient effect to the transfer of the contributions. ASFA recommends that the regulations require the applicant to provide proper identification of the receiving fund and account through use of the fund ABN and product SPIN number or account number or the like.

Fees to be charged by funds for splitting contributions
The regulations are silent on the issue of fees associated with processing an application and rollover or transfer. Superannuation funds and their service providers should be able to charge a reasonable fee or fees for the services provided to the member and the spouse of the member. It would be preferable for the regulations to make it clear that a reasonable fee can be charged for making a split.

7. Conclusion

While the Government's proposal to adopt an annual split in arrears process is the more acceptable of the three options put forward in the earlier Consultation Paper, significant concerns have been raised in regard to the proposal. The degree of concern varies between funds and providers, reflecting the wide variance of processing arrangements throughout the industry. There may be merit in permitting individual funds to determine how they would implement the arrangement within the basic rules.

However, if the ultimate aim is to assist families to maximise the benefits available in superannuation by providing an avenue for spouses to share their superannuation benefits, with the incentive of access to two low rate tax thresholds and two RBLs, then ASFA believes that this could be best achieved by permitting couples to split, on the retirement of either partner, all contributions made and earnings accumulated after a nominated start date. The issue of spouse control of a separate account during the accumulation phase should not cloud the overall financial benefit to the non-working spouse and to the family generally of delaying splitting until a benefit is paid. As well, relatively few couples would be prepared either psychologically or financially to split prior to the benefit stage.

An analysis of the administration process required for a **benefit split** system which has recently been undertaken reveals striking similarities with the administration processes funds have developed to implement the Family Law changes. Splitting end benefits would allow funds to build on and take advantage of the work already done in

implementing the Family Law changes and would significantly reduce both implementation and total transaction costs.

While ASFA acknowledges the need to contain revenue impacts for the government by limiting the quantum of an account balance that could be split on retirement, it strongly argues that the splitting option under currently favoured by the government will not, for most people, deliver the benefits anticipated by the Consultation Paper. As well, as indicated earlier in this submission, splitting at the benefit stage is unlikely to involve significant costs to tax revenue.