

## **Submission to the Senate Economics Committee—*Taxation Laws Amendment (Superannuation Contributions Splitting) Bill 2003***

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### ***Introduction***

Australian Administration Services (AAS) welcomes the opportunity to comment on the Taxation Laws Amendment (Superannuation Contributions Splitting) Bill 2003.

The changes proposed in the Bill are very important both to AAS, as one of Australia's leading superannuation administrators, and to our clients.

### **Support for policy**

We support the policy of allowing single-income couples the same tax benefits as dual-income couples with the same total income. This will address a significant equity issue in the current law.

### **Concerns with the proposed method of fulfilling policy**

We do not believe that the Bill will fulfil the policy intent in the most efficient or equitable manner.

In particular, it would result in a higher than necessary level of additional fees and charges which would lead to lower final benefits for many fund members. The superannuation fund administration industry would also have to absorb additional processing costs which could not be passed on to clients.

The administrative complexity of the proposed method of annual splitting, in a superannuation environment which is already confusing for much of the population, would greatly limit its effectiveness.

We submit that Option 4 (benefits splitting) outlined in Chapter 2 of the Explanatory Memorandum to the Bill would provide a significantly better outcome for both superannuation fund members and the industry. It would be simpler and much more efficient to allow splitting on payment of a benefit which is when the benefit becomes useable as opposed to potential.

We would be pleased to provide more details or discuss our submission further on request.

## ***About Australian Administration Services***

Australian Administration Services Pty Ltd (AAS) provides professional core administration and related customer service to superannuation funds and redundancy trusts. We specialise in services to industry superannuation funds.

AAS is a fully owned subsidiary of KAZ Group Limited, the leading Australian specialist provider of information technology and business process outsourcing services.

Through 700 employees, based in six states, we provide superannuation administration and customer services to about 47% of our target market. Our services are provided to:

- 36 funds and subfunds;
- 300 individual trustees and fund executives
- 3.4 million members
- 165,000 employers.

AAS is ISO 9001 certified as a Quality Endorsed Company.

## ***History***

The Taxation Laws Amendment (Superannuation Contributions Splitting) Bill 2003 was passed by the House of Representatives on 17 September 2003. It was referred to the Senate Economics Committee on 17 September 2003 to report by 3 November 2003.

The Committee invited public submissions by Friday, 17 October 2003.

On 14 October 2003, the Department of Treasury issued related draft regulations for separate consultation. As a result, AAS requested an extension from the Senate Economics Committee for its submission. It agreed with the secretariat to provide its submission by email by Friday, 24 October.

We note that the main detail of the superannuation splitting policy is in the draft regulations to the Superannuation Industry (Supervision) Act 1993 and the Income Tax Assessment Act 1936 rather than in the Bill. This submission takes the draft Regulations into account to obtain further information on the government's legislative intent, but does not provide substantial comment on them. A separate submission on the draft regulations will be lodged with the Department of Treasury by 31 October 2003. AAS would be pleased to provide the Committee with a copy of its submission to the Treasury on request.

## **Detailed Comments**

As stated in the introduction to our submission, the method of “Annual Splitting” introduced in the Bill (Option 2 in the Explanatory Memorandum) is not the most efficient option for splitting superannuation benefits with a spouse (“superannuation splitting”).

It would be simpler and much more efficient for members and industry to allow superannuation splitting on payment of a benefit (as per Option 4 in the Explanatory Memorandum) which is when the benefit becomes useable as opposed to potential. This “Benefits Splitting” method would be similar to the existing procedures for splitting superannuation on divorce or separation under family law and superannuation legislation.

Enabling once-off paperwork, rather than annual paperwork, would be considerably less confusing and complicated for members in an already complex superannuation environment.

The Government has already identified the need for significant education of fund members in relation to other superannuation changes. It is likely that most low-middle income members would not be sufficiently aware of the potential advantages of splitting contributions unless they seek professional financial planning or accounting advice. This is an additional cost which is not commonly incurred until relatively close to retirement.

## **Implementation costs**

Changes in legislation by their nature result in system development costs as well as costs for changes to trust deeds, member communication etc. Costs are usually passed on to fund members, either wholly or partially. Frequently, industry must absorb a portion of the costs. In any case, implementation costs affect all fund members, not only those who take advantage of superannuation splitting.

The implementation costs of benefits splitting would be substantially less than that of annual splits as this method would be similar to existing procedures. It would also enable leverage over recent costs incurred in relation to family law and superannuation.

We also note an equity argument here in relation to the benefits received by divorcing couples compared to couples with continuing marriages.

## **Ongoing costs**

Annual splitting would have significantly greater ongoing costs for members than benefits splitting.

Annual splitting would require fees to be paid on an ongoing basis rather than a single payment on leaving a superannuation fund. The resulting compounding effect on members’ account balances is likely to have a significant effect on their end benefits.

Additional fees for annual splitting are likely to arise in two areas:

- (i) potentially doubled annual administration fees (as two spouses would pay fees rather than one) and
- (ii) additional benefit payment fees would be paid annually, each time a member's contributions are split and transferred to a spouse's fund.

The administration work required to transfer split contributions would be comparable to that required for any other benefit payment (eligible termination payment). As an indicative amount, we note that our current superannuation fund clients charge their members an average annual administration fee of \$52 and an average benefit payment fee around \$70. The benefit payment fee alone is equivalent to over 3% of an equal split of annual employer contributions for a full-time employee on average earnings<sup>1</sup>. Payment fees imposed for Family Law splits by our current superannuation fund clients range from nil to \$100.

We note that it may be possible for some funds to apply a smaller splitting (benefit payment) fee if the fund were able to process all members' contribution splits at the same time (batch processing). This would not be possible under the current draft regulations as they allow each member to split contributions at a different time (limited to once annually). We will explain this concern in a separate submission to the Department of Treasury on the draft regulations.

Fees could also be slightly lower for "internal transfers" where a receiving spouse is allowed to join the transferring spouse's fund. It is not proposed to be compulsory for funds to allow this. For comparison, we note that since eligible spouse contributions were introduced in 1997, approximately two-thirds of AAS-administered funds have set up rules to allow such contributions. Of the third which do not accept spouse contributions, most are smaller funds (up to 70,000 members). Some larger funds also do not allow spouse contributions (e.g. one client with 200,000+ members). We would expect a similar proportion of clients to allow "internal transfers" under the new contributions splitting legislation.

In addition, non-working spouses may be disadvantaged by entry fees and higher ongoing fees if they join retail funds rather than non-profit public offer industry funds.

## Multiple Accounts

The effect of fees has been acknowledged by the Government and the former Senate Select Committee on Superannuation many times, most recently in relation to the latest amendments to the Superannuation Industry (Supervision) Regulations introducing "portability". One of the Government's stated aims for the portability regulations was to reduce the impact on members' benefits due to duplication of fees from having benefits in more than one fund.

We submit that annual splitting of contributions is likely to lead to further duplication of administration fees as two spouses would pay two sets of fees rather than one. This would be avoided by using the benefits splitting model.

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<sup>1</sup> Calculated as a transfer of 50% of employer contributions (9% of full time adult average weekly ordinary time earnings quoted in ABS figures for February 2003):  $50\% \times 9\% \times \$48,896 = \$2,200$

While we acknowledge that under a benefits splitting model a receiving spouse would have no direct control on his or her superannuation until the transferring spouse is paid a benefit, we query whether such control would have a sufficient effect to overcome that of the additional fees. This is particularly important for middle-income couples who are potentially the biggest beneficiaries of the policy to allow splitting of compulsory superannuation (as higher-income couples are more likely to be take advantage of the existing facility for voluntary spouse contributions).

## **Limits to Splittable Contributions**

As discussed in paragraph 1.22 of the Explanatory Memorandum, the Government intends to impose limits on contribution splitting via regulations to ensure that sufficient funds remain in the original member's accounts to pay the superannuation surcharge. The draft regulations allow up to 100% of undeducted contributions to be split, and up to 70% of deductible (usually employer) contributions.

Such limits will cause additional administration requirements and confusion among members. Splitting at benefit payment stage could avoid the complexity of splitting limits for surcharge purposes.

In addition, it is possible (for example, as a result of insurance premiums, administration fees, and/or negative investment returns) for a member's balance at the time of a split to be *less* than the contributions received during the year. Unless splitting is limited to the member's account balance, funds could easily be required to subsidise one member's contribution splitting from the accounts of other members of the fund. We will address this issue in our separate submission to the Treasury on the draft Regulations (to be submitted by 31 October 2003).

## **Availability to all members**

The Explanatory Memorandum (confirmed by draft Regulation 6.40) indicates that contribution splitting will only be available to members of accumulation funds:

(Page 4) "Members of accumulation funds will be able to split both personal and employer contributions with their spouse, including compulsory Superannuation Guarantee contributions."

Many members of defined benefit funds have both accumulation and defined components of their benefits. It would be desirable for the same splitting rules to apply to all members.

The restriction to accumulation members would be unnecessary under the benefits splitting model. Even with the annual splitting model, it would be possible to allow splitting for the accumulation component of defined benefit members' entitlements.

## **Insurance**

The Explanatory Memorandum discusses insurance under the Annual Splitting and Benefits Splitting models:

Paragraph 2.28 (annual split): "...for members of some superannuation funds, splitting may provide the low income or non-working spouse with improved access to cost-effective death and disability insurance"

Paragraph 2.63 (benefit split) "...The receiving spouse would not have...any scope for improved access to cost-effective death and disability insurance."

We query the extent that insurance will be available to low income or non-working spouses of members. Even if insurance is available, currently many insurers are not willing to offer the same low rates available to members due to concerns about "selection". Potentially competition would overcome this concern, but it is not clear how soon, if ever, this would occur.

As a comparison, most<sup>2</sup> AAS-administered funds allow "non-member spouses" to create an account within the fund following a family law split of benefits. Of these funds, the vast majority do *not* provide insurance cover for non-member spouses.

### **Equity with dual income couples**

The policy's intent is to allow families with one high income spouse and one low-income/non-working spouse to be on an equal footing with families who have the same total income from two medium-high income spouses, as described on page 3 of the Explanatory Memorandum:

*"[to] provide single income couples, including those not able to make voluntary contributions, with access to two ETP low-rate thresholds and two reasonable benefit limits in the same way as dual income families."*

We submit that splitting contributions at the time of benefit payment would make it easier to fulfil this policy intent. The Explanatory Memorandum explains in relation to Option 4 how the additional cost could be contained without significant additional administration:

*"2.55 To reduce the administration burden on providers (and eliminate the need for providers to track contributions and earnings accrued after commencement of the measure), a simplifying calculation of benefits eligible for splitting could be used. In principle, eligible splitting benefits could be the total benefit multiplied by the proportion of time spent in employment after 1 July 2003, relative to total time in employment (a member's eligible service period could be used for this purpose)."*

Splitting total benefits would make it even easier to fulfil the policy intent, but initially at a significantly greater cost to the Budget<sup>3</sup>. Splitting benefits on a proportional basis at the time of benefit payment as outlined above would provide a simple means for a future government to meet the policy intent by allowing all benefits to be split. It would also provide greater equity

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<sup>2</sup> There are significant superannuation funds, including one fund with 200,000+ members, which does not allow non-member spouses to join.

<sup>3</sup> The proportional split would only be transitional: in time all employment will be post-2003.

with divorcing or separating couples where benefits are split under superannuation and family law legislation.

## **Potential for Fraud**

Due to the greater volume of transactions, there is a much greater potential for fraud with annual contributions splitting. The possibility of fraud is identified in the Explanatory Memorandum which states:

*2.35 Superannuation providers may also need to take steps to establish that the spouse is bona fide and to check account details.*

The term “spouse” is defined in the Superannuation Industry (Supervision) Act 1993 as follows:

*spouse, in relation to a person, includes another person who, although not legally married to the person, lives with the person on a genuine domestic basis as the husband or wife of the person*

The requirement to check the bona fide nature of a spouse is particularly difficult in the case of a *de facto* spouse. The requirement to do so annually would impose a significant burden on fund trustees and administrators.

If the proposal for annual splitting (rather than benefits splitting) proceeds, we strongly recommend a requirement for a formal declaration from the member (and possibly the spouse) to confirm the bona fide nature of the spousal relationship.

## **Member Disclosure**

Superannuation funds must meet considerable disclosure requirements imposed by Chapter 7 of the Corporations Act 2001. This includes requirements relating to application forms and Product Disclosure Statements, and to ongoing reporting. The overlap between the Corporations Act and the proposed superannuation splitting legislation does not appear to be addressed in the Bill or the draft Regulations. We will address this issue in more detail in our separate submission to the Treasury on the draft Regulations.

## **Deductions for superannuation contributions by the self-employed**

Items 13 and 14 of Schedule 1 to the Bill will amend section 82AAT of the Income Tax Assessment Act 1936 which relates to tax deductions available to substantially self-employed persons.

We note the lack of detail in the Bill on the impact of contributions splitting on the existing deduction regime available under sections 82AAS and 82AAT. We recommend that this issue be reviewed to clarify the intent and effect of items 13 and 14.