28 January 2022

Budget Policy Division
Department of the Treasury
Langton Crescent
PARKES ACT 2600

Email prebudgetsubs@treasury.gov.au

Dear Sir/Madam

Pre-Budget submission (2022-2023)

The Actuaries Institute ("the Institute") is the professional body for Actuaries in Australia. Actuaries work in a wide range of fields including insurance (life, general and health), superannuation and retirement incomes, enterprise risk management and data analytics. The Institute educates members and supports ongoing professional development. It is also active in contributing to public policy debates where its members have relevant expertise.

The Institute provides commentary on public policy issues where there is uncertainty of future financial outcomes. We strive to act in the public interest and our contributions to public policy issues are guided by the principles of transparency, a 'level playing field' and good regulation (proportional and the most appropriate regulatory tool/s).

The Institute encourages Treasury to consider, as part of this year's pre-budget deliberations, our views in the areas of climate change and natural disaster resilience, life insurance product rationalisation and supporting disability income claimants, taxation clarification on AASB17 for insurers and on non-arms' length income and expenditure for superannuation funds and members, and reforms in retirement income, Aged Care, and private health insurance and health data.

Climate Change and Natural Disaster Resilience

The Institute welcomes the previous budget funding increases towards increased resilience, including as a key part of that the establishment of the National Recovery and Resilience Agency (NRRA). As that funding, and any additional funding, is allocated we encourage the initial focus to be on understanding and gathering data on the impacts of the changing climate on natural disasters, heat stress and actions of the sea. This can inform effective sizing and prioritisation of adaptation investment to sustain economic growth and development in the changing climate. The Australian Actuaries Climate Index clearly shows Australia is experiencing a strong trend of more extreme weather – 42 of the last 43 seasons have shown extreme weather, particularly due to high or low temperatures, but also extreme rainfall and consecutive dry days, and rising sea levels.

The Institute notes the National Construction Code plays a critical role in improving resilience. Achieving this will require the Australian Building Codes Board (ABCB) to expand its focus to include property protection, community resilience, and consideration of future climate risk. This is consistent with the Global Resiliency Dialogue between building code developers and

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research organisations from Australia, Canada, New Zealand and the United States (CANZUS). We recommend increased funding to the ABCB to support expanding its focus and to develop a whole of life approach to understanding the benefits and costs of uplifting standards. As buildings are a significant source of greenhouse gas emissions, an updated Code could play an important role in achieving Australia's long-term goals for emissions reduction.

The Institute also welcomes the Government's funding of the Australian Climate Service (ACS) to provide data services to Emergency Management Australia and the NRRA. We recommend the Government also considers funding for the ACS to create public data assets, so that business and industry can assess and improve the resilience of the private sector.

The Institute remains available for consultation on the details of the cyclone and related flood damage reinsurance pool, particularly in light of the experience of cyclones this summer. As noted in our submissions on the pool consultation[1], technical clarification of the event definition and transparency and disclosure of data and the pricing framework are crucial, as well as the pool being accompanied by other risk reduction measures to ensure a resilient Australia.

Life Insurance - Product Rationalisation and Supporting Disability Income Claimants

The Institute strongly supports the development of a life insurance product rationalisation framework, as first announced in the 2021-22 Budget and which Treasury continues to work through. Consumers will benefit directly with more appropriate and contemporary life insurance products, and indirectly through gains in efficiency at an industry level and greater appetite for innovation amongst insurers if there are mechanisms to limit the negative impact of legacy products.

For any framework to be viable, it will need to incorporate two elements:

1. it must be compulsory; and
2. genuine rationalisation of product features will need to be allowed.

The Institute notes while product rationalisation may adversely impact some consumers relative to the outcome they would have experienced had there been no rationalisation, these impacts can only be determined *ex post*. Provided appropriate checks and balances are in place at the time that the rationalisation is put into effect (for example, a verification exercise to ensure that every individual policyholder is *ex ante* expected to be no worse off on average given potential future outcomes), then the risk of a potential adverse impact should be accepted. Failure to accept this risk would likely render any product rationalisation framework unworkable in most situations.

Other accommodations will be needed, including grandfathering under Superannuation Industry (Supervision) Regulations, and ensuring that capital gains tax events are not triggered, in order for the framework to be viable.

The Institute encourages consideration be given for life insurers to support rehabilitation efforts for disability income claimants. The Life Insurance Act currently prevents this. Allowing this support could significantly improve rehabilitation outcomes.

[1] Refer submissions of 17 December 2021 on the draft legislation and 18 June 2021 on the initial consultation.

AASB 17 and Insurance

The new accounting framework for insurance contracts is due to come into effect from 1 January 2023. A major issue for insurers in planning for the transition is to understand the tax treatment of the change. The Institute encourages the Australian Taxation Office to develop, and release, proposed tax treatments as soon as possible, and before 30 June 2022.

Retirement Incomes

The Institute supports proposals that a clear objective should be legislated for the retirement income system as a whole, as well as for each pillar and principles for their integration.

The Institute's Public Position Statement on Securing Adequate Retirement Incomes for an Ageing Australia highlights key areas for reform of the Australian retirement income system. The more detailed Supporting Document provides additional context. The key areas for reform focus on setting an objective, simplifying the system, improving efficiency, delivering adequacy and improving equity.

The Institute supports the introduction of a Retirement Income Covenant and urges legislating the Covenant to be a priority. Superannuation fund trustees should be required to have an appropriately designed retirement strategy and make available to their members a variety of retirement solutions appropriate to their circumstances.

Non-Arm's Length Income/Expenditure (NALI/E) Rules for Superannuation

The Institute urges an urgent response to the concerns the Joint Bodies[2] have made to the Office of the Minister for Superannuation (copy attached) regarding the need to amend the existing non-arm's length income (NALI) and non-arm's length expenditure (NALE) rules in section 295-550 of the *Income Tax Assessment Act 1997*.

As outlined in those representations following the release of the ATO's recent Law Companion Ruling LCR 2021/2 (LCR) and Practical Compliance Guideline PCG 2020/5 (PCG), it has become evident that the administration of the provision is broader than the original policy intent. This could have significant adverse and unintended tax implications for many superannuation fund members.

Aged Care

The Institute's Green Paper, Aged Care Funding: Assessing the Options and Implications, released in December 2021, finds that current policy settings are likely to result in significant pressures on the Commonwealth budget over time. The Aged Care sector's current funding accounts for 1.6% of GDP (or around $32 billion per annum). But over the next 20 years as Baby Boomers age and need access to more services, the figure will rise to 2.9% of GDP, potentially making Aged Care the fastest growing line item in the budget and even stronger than projected in the Intergenerational Report. The question of what is a sustainable and equitable sharing of funding between individuals and government requires further investigation and the Green Paper calls out specific areas.

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[2] The Joint Bodies are Actuaries Institute, The Association of Superannuation Funds of Australia, Australian Institute of Superannuation Trustees, Chartered Accountants Australia and New Zealand, CPA Australia, Financial Planning Association of Australia, Financial Services Council, Institute of Public Accountants, National Tax and Accountants Association, Self-managed Independent Superannuation Funds Association, SMSF Association, Tax & Super Australia, and The Tax Institute.

There is also an opportunity for better financial regulation to ensure continuation of care and to lessen the risk to taxpayers of the costs of rescuing failed service providers, or an Aged Care home.

Private Health Insurance and Health Data

The Institute encourages the Government to continue exploring options and reforms to support the affordability of private health insurance including risk equalisation, lifetime health cover and the prostheses list, and to encourage innovation in the sector such as out of hospital care which, during the pandemic, has proven to be a necessary and effective means of ensuring a strong health system. We look forward to contributing to the Department of Health's ongoing reviews and release of detailed information during 2022.

We also encourage the Government to increase its effort in the use of data in health. As health data becomes more widespread, investments in the national ecosystem of health data would enable Australia's policy agenda to be better calibrated with health outcome objectives.

Should you wish to discuss any aspect of this submission or make arrangements for a meeting with Institute representatives please contact Elayne Grace, Chief Executive Officer of the Actuaries Institute, at elayne.grace@actuaries.asn.au or phone (02) 9239 6100.

Yours sincerely

Annette King
President

3 September 2021

Senator the Hon Jane Hume
Minister for Superannuation, Financial Services and the Digital Economy
PO Box 6100
Parliament House
CANBERRA ACT 2600

By email: senator.hume@aph.gov.au

Cc The Hon J Frydenberg Treasurer
The Hon M Sukkar, Assistant Treasurer
Ms Lynn Kelly, Retirement Advice and Investment Division, Treasury

Dear Senator,

Joint Submission: Superannuation Non-Arm's Length Income Rules

Chartered Accountants Australia and New Zealand, CPA Australia, the Institute of Public Accountants, The Tax Institute, the SMSF Association, the National Tax and Accountants Association, the Australian Superannuation Funds Association, the Actuaries Institute, Self-Managed Independent Superannuation Funds Association, the Financial Planning Association of Australia, and Tax & Super Australia (together **the Joint Bodies**) write to you as the peak professional accounting, tax, actuarial and superannuation bodies in Australia representing both large APRA and small superannuation funds (e.g. SMSFs and small APRA Funds with no more than 6 members).

Issue to be addressed

The introduction of the non-arm's length expenditure (**NALE**) rules,[1] and the ATO's interpretation of these rules, as published in the recently finalised Law Companion Ruling LCR 2021/2, will have far reaching and, it is submitted, significant harmful consequences; it is difficult to imagine that such outcomes were intended. These rules apply with effect from 1 July 2018, including with respect to income derived as a result of an arrangement entered into prior to that date.[2]

We note that even the ATO's final ruling itself at [91] states:

[1] *Treasury Laws Amendment (2018 Superannuation Measures No. 1) Act 2019*.

[2] Given the potentially severe consequences of the new law, the ATO has allowed a grace period in practical compliance guide PCG 2020/5. The ATO will not allocate compliance resources to determining whether the NALI general expenditure rule applies to the 2021-22 and earlier years.

Nevertheless, the Commissioner is alive to concerns that a finding that general fund expenses are non-arm's length is likely to have a very significant tax impact on the complying superannuation fund, even where the relevant expenses are immaterial.

While the Joint Bodies have a number of issues with the reach of these provisions, our overarching concern is that the ATO's interpretation of the law means that, rather than merely addressing the mischief at which the government policy was directed, the rules could result in unwarranted significant and long-term detriment to fund members and could operate in conflict with a range of trustee obligations such as the best financial interests duty (**BFID**) rule in the *Superannuation Industry (Supervision) Act 1993* (Cth).

For example, unallocated expenses (no matter how minor in nature), that are incurred on a non-arm's length basis, will generally trigger non-arm's length income (**NALI**) tax (currently 45%) on all of the income of the superannuation fund for that particular year. In an SMSF context, a non-allocated expense of $1,000 that is not charged for, or is undercharged, in a financial year the SMSF derives $100,000 in assessable income, will result in $45,000 of tax for the SMSF. That is, by not paying $1,000, the SMSF incurs additional tax of up to $45,000.[3] In the Joint Bodies' view, such an outcome is both unintended and disproportionate.

In a large APRA fund context, the application of the ATO's interpretation of the rules at least conceptually could give rise to extremely large increases in funds' tax liabilities. If a large APRA fund's usual tax liability (for contributions income and investment income combined) was $1 billion in a particular tax year, the incurrence of a $1,000,000 general expense to a related entity of the fund — where it was subsequently determined that an arm's length amount should have been $1,500,000 — could give rise to an increase in this tax liability from $1 billion (at the usual superannuation fund rate of 15%) to $3 billion (at the NALI tax rate of 45%). Again, in the Joint Bodies' collective view, such an outcome is disproportionate and significantly harmful to the retirement outcomes for members.

While the ATO notes in LCR 2021/2 that it would not expect the rules to apply to the ordinary operations of large APRA funds, the *mere existence* of these potentially catastrophic consequences is likely to add significant complexity and costs to funds' operations in seeking to avoid any possible risk that the rules could apply. Ultimately these costs will be borne by the members of the funds. The NALI consequences are also contrary to the fund trustee's BFID where trustees are broadly required to minimise expenses with a reverse onus on trustees to prove that each expense has been in beneficiaries' best financial interest.

A number of the Joint Bodies have been working for several years seeking an appropriate response from the ATO in relation to its ruling and guidance process, without success.

Request for legislative amendments

Given the significant impact these rules may have on retirement savings, the Joint Bodies ask that the Government make an announcement that they will review the NALI rules in section 295-550 of the *Income Tax Assessment Act 1997* (Cth) and encourage the ATO to provide further administrative relief until this review and relevant amendments to the legislation are enacted (retrospectively to the original starting date of 1 July 2018).

Such announcement would:

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[3] The additional tax will range from $30,000 to $45,000 depending on whether the superannuation fund is in pension phase and/or whether the income includes discounted capital gains.

- exclude arrangements where the other party(ies) to the transaction with the fund do not include a fund member or an associated person of a fund member;
- ensure that the potential for general expenses to taint all the income of the fund at the NALI tax rate ceases to apply;
- ensure that the NALI rule operate in a manner which is more consistent with other anti-avoidance provisions, thus ensuring the application of the rule is proportionate to the problem to be addressed; and
- provide the trustee with an opportunity to correct unintended errors.

The Joint Bodies are currently working with the Retirement Income Division within the Department of Treasury on the issue.

We would welcome the opportunity to discuss this important issue further with you. If you are willing, please contact The Tax Institute's Director, Andrew Mills on (02) 8223 0005.

Yours faithfully,

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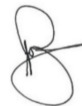

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