

EXPLANATORY MEMORANDUM TO PROFESSIONAL STANDARD 406 UNSEGREGATED SUPERANNUATION LIABILITIES

June 2018

1. About this Explanatory Memorandum

This Explanatory Memorandum has been prepared by the Superannuation Practice Committee (SPC) to assist Members in understanding new Professional Standard 406 (Unsegregated Superannuation Liabilities) (PS 406). PS 406 replaces mandatory Guidance Note 451 – Unsegregated Superannuation Liabilities – Certificates by Actuaries under Sub-sections 283(3) and 283(4) of the Income Tax Assessment Act (GN451) which will be withdrawn on the commencement of PS 406.

2. Background

In December 2016, a draft of PS 406 was exposed to Members. While no feedback was received from Members, the draft was not finalised as the SPC continued to discuss the draft with other stakeholders and further changes to the draft became necessary to accommodate amendments to superannuation legislation that took effect from 1 July 2017.

A new exposure draft was issued in March 2018. Two responses were received from Members. One response suggested that in the section listing the content required to be included in the actuarial certificate in statement 7(xix) that “Net Assets” replace “assets”. The SPC decided not to make the change because the current wording mirrors the statement required to be made by actuaries in the legislation. Because the legislation uses the word “assets” the SPC felt it was appropriate to retain the same word.

The second response was a question on the timing of the commencement of the standard.

3. Reasons for Change

3.1. Changed Legislation

The December 2016 exposure draft incorporated amendments reflecting that, as part of the Simpler Super legislative changes which were generally effective from 1 July 2007, Part IX of the Income Tax Assessment Act 1936 (Cth) (“1936 Act”) was rewritten and incorporated into Division 295 of the Income Tax Assessment Act 1997 (“ITAA 1997”). The changes applied with effect from the income tax year ended 30 June 2008.

Since the December 2016 exposure draft, further changes to PS 406 were required as a result of the legislative changes to superannuation that took effect from 1 July 2017. These changes introduced the new concept of ‘retirement phase’ superannuation income stream benefits to enable (i) the inclusion in current pension liabilities of qualifying deferred superannuation

income streams and various other 'innovative income stream products' permitted under the new legislation, and (ii) the exclusion of account based transition to retirement pensions that are not yet in the retirement phase. Legislation was also updated in respect of Disregarded Small Fund Assets.

PS 406 has also been updated to reflect the Australian Taxation Office (ATO) promulgated view that, where a fund's only superannuation liabilities at a particular time are in respect of retirement phase superannuation income stream benefits prescribed by the relevant regulations, sections 295-285(4) & (5) of the ITAA 1997 mean that the assets supporting those income streams are deemed to be Segregated Current Pension Assets at that time, even if this applies for only part of an income year.

Whereas under the previous legislation the ATO was empowered to specify requirements for actuarial certificates relating to pensions tax exemptions (which it did via Income Tax Ruling IT2617), no such power is provided under the present Act. To provide continuity (and as requested by the ATO) the requirements of IT2617 are now included in PS 406 (with appropriate modifications).

3.2. Changed APRA requirements

APRA Prudential Standard SPS 114 – Operational Risk Financial Requirement establishes requirements for an RSE licensee to maintain adequate financial resources to address operational risk events that may affect its business operations. This requires some APRA regulated superannuation funds to hold reserves in addition to member liabilities.

3.3. Changed PS 400 in respect of Defined Benefit Funds

PS 406 reflects changes to PS 400, such as the treatment of assets held within a fund to meet the Operational Risk Financial Requirement.

3.4. Changed Actuaries Institute Policy

Actuaries Institute Policy now requires mandatory guidance notes to be replaced by professional standards.

3.5. Alignment with legislation

Under ITAA 1997 section 295-390, in respect of the relevant investment income earned on unsegregated assets, the proportion of taxable income earned on those assets in a year of income that is exempt from tax is:

$$\frac{\text{Average value of current pension liabilities}}{\text{Average value of superannuation liabilities}}$$

PS 406 is expressed in these terms to allow for the presence of surplus and reserves that are not part of superannuation liabilities.

4. Partially funded State public sector schemes

In providing feedback on draft PS 406, the ATO has advised that it is considering whether, on one view, the approach has the potential to establish exempt proportions certified for some partially funded State public sector superannuation schemes that are higher than may have been intended having regard to the scheme's funding arrangements and position. The ATO has also advised that it continues to monitor risk in relation to exemption claims, and may undertake reviews in this regard if they conclude that the formula in this Professional Standard does not reflect the policy intent. The ATO has undertaken to write to the Institute setting out its position, after which the Institute will consider whether any change to PS 406 is required.

Ideally this matter would have been resolved before PS 406 was issued. However, noting that it affects only a small number of actuaries and schemes, and after discussion with the ATO, the Institute has decided to proceed with issuing PS 406 now, with the inclusion of a new paragraph 5.4 which draws attention to this matter. Under paragraph 5.4, affected Members must make their clients aware of the situation in writing and suggest that their clients may wish to consider obtaining their own tax advice and or legal advice on the matter.

As indicated in paragraph 1.3.4 of PS 406, if there is a conflict between a Professional Standard and any legislation, the law takes precedence.

5. Commencement Date

PS 406 will apply to certificates in respect of financial years commencing on or after 1 July 2017 which are signed on or after 1 July 2018.

END OF EXPLANATORY MEMORANDUM