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SELECT COMMITTEE ON SUPERANNUATION AND
FINANCIAL SERVICES

Reference: New Business Tax System (Miscellaneous) Bill (No. 2)

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SENATE

SELECT COMMITTEE ON SUPERANNUATION AND FINANCIAL SERVICES

Monday, 26 June 2000Monday, 26 June 2000

Members: Senator Watson (*Chair*), Senator Sherry (*Deputy Chair*), Senators Allison, Chapman, Conroy, Hogg and Lightfoot

Senators in attendance: Senators Allison, Hogg, Lightfoot, Sherry and Watson

Terms of reference for the inquiry:

New Business Tax System (Miscellaneous) Bill (No. 2) 2000.

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Committee met at 8.36 a.m.

PRAGNELL, Mr Bradley John, Superannuation Policy Adviser, Certified Practising Accountants Australia

WYATT, Mr Murray William, Chair, Superannuation Centre of Excellence, Certified Practising Accountants Australia

CHAIR—I declare open this public meeting of the Senate Select Committee on Superannuation and Financial Services. Welcome to all. On 21 June the Senate referred the provisions of the New Business Tax System (Miscellaneous) Bill (No. 2) 2000 to the committee for inquiry into the impact of certain aspects of the bill on superannuation funds. The committee is required to report to the Senate on 27 June 2000, which is tomorrow. Although there is only a short time available for the committee to conduct its inquiry, the aim of today's hearing is to take evidence from key organisations and interested parties on the provisions of the bill.

All the witnesses who appear before the committee are protected by parliamentary privilege with respect to the evidence given before the committee. This means that they are given broad protection from action arising from what is said and that the Senate has power to protect them from any action which disadvantages them on account of the evidence given before the committee. The committee prefers to conduct its hearings in public. However, if there are any matters which witnesses would like to discuss with the committee in private, the committee will consider their request. I welcome the representatives from the Certified Practising Accountants and I invite you to make an opening statement.

Mr Wyatt—What we would like to do is to go through the ramifications of the recent press release in three basic categories. The first category is if I retire now, the second category is if I retire between 1 July 2000 and 30 June 2005 and the third category is if I cannot or do not want to retire after that five-year period. If I retire now, pre 30 June 2000, which is in four days time, I do not pay any CGT whatsoever. The difficulty is we have not got legislation and it is very difficult from this position for someone that is preparing to retire to decide whether to do so or not.

CHAIR—You say pay no CGT. For the *Hansard* record could you describe the circumstances?

Mr Wyatt—If you change from the accumulation phase of a superannuation fund into an allocated pension phase, by way of example. The second case is if a person retires, as per the press release, between 1 July 2000 and 30 June 2005, no CGT is payable up till 30 June 2000. Thereafter, you pay CGT from 1 July 2000 to either the date you do retire or 30 June 2005. Therefore, for self-managed superannuation funds and SAFs, which are small APRA funds, if you are planning to retire you will need to get some form of valuation that will be acceptable to the tax office. You have to have a starting point or a valuation done at 30 June or 1 July to see what gains are made between 1 July 2000 and, at the latest, 30 June 2005. If this is done at market value, which would be the normal course of events, you need to work out the effect of this form of valuation on the assets of excluded funds and self-managed superannuation funds and SAFs at 30 June. I have worked through an illustrative example of the Telstra 2 share price.

If I could table that document I think it would make it easier rather than my just reading the figures.

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CHAIR—Is it the wish of the committee that the document entitled ‘Market value or higher value of market value or cost’ be incorporated in the transcript of evidence? There being no objection, it is so ordered.

The document read as follows—

Mr Wyatt—There was a precedent. We were particularly concerned about how the valuation is going to occur. When superannuation funds at 30 June 1988 became subject to capital gain and did not have any pre-component, you had the choice of the higher cost or the market value. We are particularly concerned that, with only four days to get these valuations—which is particularly difficult in relation to property—if it is market, there are serious consequences that can occur because of the fluctuation in asset prices. I can illustrate that by simply working through this illustrative example in relation to Telstra 2. These are approximate figures—I did not have time to look up the exact share price but they are thereabouts. If we assume, in relation to Telstra 2, that we purchased the share in November 1999 for \$4.50 that would be our cost price. The market value at 30 June 2000 is about \$3.70. To illustrate what I am saying, if you cannot use the higher of market or cost and we are forced to use purely the market price, the cost value would be \$45,000 if we had 10,000 shares. The actual value of those shares would be \$37,000. If at some time in the future Telstra 2 gets to \$6, and if we assume that happens on January 2004, we would be paying the CGT from 1 July 2000 through to January 2004. If the valuations are done at market, the gain is from the lower cost base, not what you paid for it but the valuation at 1 July, so the gain would be \$23,000. However, you have physically paid \$45,000 for the share. In relation to that, because the CGT does not apply until 1 July there is no adjustment for what happens prior to that. Therefore, it would be our recommendation that the legislation should incorporate—the precedent is there in relation to the valuations that were done in June 1988—that it should be the higher of cost or market value.

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CHAIR—Under what bill?

Mr Wyatt—I did not have time to look the section up.

Mr Pragnell—It is in the Income Tax Assessment Act.

Mr Wyatt—It is a particular section. I can give it to you by way of reference. It works as badly to disadvantage people if the actual price goes the other way. At market value it would be \$37,000 and, if the share price falls away to \$3, we would have a CGT loss of \$7,000, but in relation to what we paid for the share the loss would be, in effect, \$15,000. It is very important that if this proceeds the valuation should be at the higher of market value or cost otherwise we are going to have these sorts of anomalies. We have a precedent for that in June 1988 when CGT was introduced to all superannuation funds and they could no longer have any pre-assets.

In relation to the valuation, at first glance you would consider that it is only going to apply to those people that are intending to retire in the five-year time frame because if you retire today there will be no CGT applicable on the assets, and if you retire after the five-year period CGT is applicable on the whole amount—and I will come back to that in a moment. So at first glance, when I was working through it, I thought that the valuation issue would only apply to those people that are intending to retire in that five-year window. However, when you think about it, you have to take into account the unforeseen: what happens if you do get hit by the blue bus and you become permanently incapacitated or you die and you want to pay an allocated pension either to yourself as you are incapacitated, or to beneficiaries or minors under the current legislation?

Effectively, what is going to happen to all excluded funds or self-managed superannuation funds and SAFs is they will need, within a four-day time frame, to get valuations on property and, one would hope, the higher of cost or market value will apply to such things as shares. The time frame to organise the valuations is very tight, given that under the accounting standards, because they are non-reporting entities, you do not have to have them valued every year. So, effectively, the valuation problem is going to apply to everybody because no-one is going to know what their circumstances are going to be within that five-year period because of the unforeseen.

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CHAIR—For the purpose of completeness of the record, how are pre-1985 assets affected?

Mr Wyatt—If it is a pre-1985 asset it will not be subject to—

Mr Pragnell—There is no pre-1985 for superannuation funds.

Mr Wyatt—No, because it is June 1988.

Mr Pragnell—They had to do the valuation as of June 1988 on market value or cost—

Mr Wyatt—So everything is subject to CGT going forward.

Mr Pragnell—Yes, going forward.

CHAIR—Thank you.

Mr Wyatt—The third thing is something that is pretty dear to my heart. I am 48 years old. I have been in superannuation for a long time. I cannot retire within that five-year time frame because I will not be 55; I will be 53. I cannot qualify to meet the window, so I will have to pay the CGT on the lot: since June 1988, when we lost the pre status, I will be paying the CGT on all the assets in the fund if I move from the superannuation phase through to the allocated pension stage. So, from my perspective, I feel that the application of this tax is very retrospective and it is grossly unfair because it is discriminating against the larger percentage of the population.

What we are proposing is that because of the very short time frame, because people have not had time to address the issues and get valuations, the CGT application, if it is going to be introduced, should apply from 1 July 2001 and it should be across the board. That would mean that people would have time to organise their affairs and, if CGT is going to apply, it would be across the board to all people in that phase from that point in time forward.

In relation to the dropping of the current pension liability method—and I will not go into the details of it—members of the Superannuation Centre of Excellence that deal with large funds have said to me that it is extremely difficult to undertake the segregation and desegregation of assets for the larger funds. I think it is very important that, whatever happens, the taxes must be comparable to SAFs and self-managed superannuation funds because they will not be able to have the pooled membership and, if there is any return to the actuarial calculations, they will not

be able to apply to smaller funds because they will not have the pool of memberships or pool of assets.

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CHAIR—You said they will not have the pool of assets under APRA rules. What do you mean by that?

Mr Wyatt—If it all goes to the segregation of assets method, it would be on a similar time frame. If it goes back to any form of current pension liability method because of the difficulty of applying the segregation of assets method to the larger funds, we must make sure that there is no disadvantage to the smaller funds. They will not be able to apply any form of the current pension liability method because it does not make any sense if all the members are either in allocated pensions or not. If you have got all your members in allocated pensions then the application of some form of current pension liability method is a nonsense because you have not got anyone in the accumulation phase to have some percentage on what is the superannuation element and what is the allocated pension element in terms of CGT and income flows. The point we are making is that we think it is fairly important that when the legislation is passed large and small funds are on an equal footing in terms of the way they are taxed in terms of shifting from superannuation to pension mode.

Mr Pragnell—Briefly, just to comment on the Assistant Treasurer's press release of 20 June, it did address certain immediate concerns for individuals we have been in communication with who felt that they were being forced to bring forward retirement decisions in a fashion which was very hasty and possibly ill considered. On that hand it does deal with some cases and does provide relief for certain individuals going forward, but I would like to reiterate the points that Murray made that we still have the issue of retrospectivity in terms of pensions commencing on or after 1 July 2005. We still have a retrospective application of capital gains tax in that instance and, secondly, we still have the 1 July 2000 date which is the cut-off and which is only days away now. As Murray said, in terms of the ability of people to seek valuations and make certain plans for their retirement we would like to see a single date. Murray suggested 1 July 2001 when the clock starts ticking for all funds in terms of capital gains going forward. That would probably be much fairer, more equitable and less complicated than what is being proposed here in the media release.

CHAIR—In terms of valuations though, an accountant could look up the *Financial Review* and get the public prices at 30 June. That would not be a problem. The valuer has to value property. He could still do it in August because he would know what price movements had occurred since June. It is not as if you must go out and purchase a good by a certain time. You do have time to get your valuations, in a sense.

Mr Wyatt—Because it is going to apply to all funds it is a matter of making sure that if this is going to apply it applies in a way similar to that applied in June 1988.

CHAIR—I can see that point.

Mr Wyatt—We need to get that out into the profession and the general public because it does apply to everybody under the current press release because of unforeseen circumstances. We will have to get kerbside valuations, for example, of property. We are not saying that share

prices are a dilemma because they are on the public record but a lot of smaller funds, as you would realise from the business or property exemptions, have got property in the superannuation funds and/or within pre-existing unit trusts or, under recent legislation, non-g geared unit trusts or as a tenant in common arrangement.

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My point is that, in order for it to be done in an orderly manner and because the workload is so tight for business people at the moment in relation to the GST—my practice has been running some GST seminars and the business people are really struggling to cope with those sorts of issues—for them to digest the implications in terms of their retirement under the current press release is another significant burden on them.

Senator SHERRY—It has been said by the Treasurer and the Assistant Treasurer that this is part of the Ralph business tax reforms. I cannot find it in Ralph. Can you?

Mr Pragnell—In reviewing the final Ralph report and the Treasurer's response to Ralph in attachment N—and we have read through that on many occasions—unless you take a very creative reading of what is in those documents, it is very difficult to find this proposal.

Senator SHERRY—On any reasonable reading, it is not there?

Mr Pragnell—It is not there.

CHAIR—Didn't it refer to neutrality and the quality of funds across the spectrum or something like that?

Mr Pragnell—There were some broad statements, but in terms of this specific proposal one would have to take a very creative reading to apply it in that instance. I think we have great difficulty with saying that this is actually part of Ralph.

Senator SHERRY—Does this simplify superannuation, reduce administrative compliance and reduce costs?

Mr Wyatt—With reference to the demonstration in our presentation this morning, the fact that it applies to retirees within a five-year period significantly increases its complexity. One of the concerns I have not actually brought up is about what is going to happen in five years time. What we are going to defer is the crisis in retirees' minds at the moment—that is, 'I will have to retire by 30 June 2000.' All we are doing is extending that crisis, and in five years time there will be people who are 50 now saying, 'What do I do? Do I get out?' They may not really want to retire but, because of the CGT, for financial reasons rather than for all the right reasons they may take the plunge when they ought not to. The five years does not actually solve anything; it just defers it. I think it significantly increases its complexity. That is why we are saying that if you are going to apply it and apply it equitably across the board, apply it to everyone; give people time to digest the issues and apply it from 1 July next year.

Senator SHERRY—Effectively, is this an additional taxation of superannuation products?

Mr Wyatt—From where we currently are, there will be certain people who have done the calculations to retire—we will just take an allocated pension rather than a fixed term pension, because it is easier to explain—and the maximum-minimum drawdowns would be affected because the account balance would be reduced by the CGT liability. Notwithstanding that it will go to some reserving account and be payable when the asset is sold, it still will not be available for distribution to that member through that member's account.

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Senator SHERRY—Effectively, the base is smaller so the annuity income is smaller.

Mr Wyatt—The base is smaller, therefore the income flow is smaller and therefore there will be some people who will say, 'I do not have quite enough to retire.' It will also affect the other pensions because actuarially the asset base will be smaller so the income flows will be smaller.

Senator SHERRY—You have mentioned timing. I have had it put to me that if this legislation is passed, it will be impossible for many funds offering an annuity product to make the change in four or five days; that it is just impossible administratively to do in those circumstances. Can you indicate to us from your experience that, if this legislation is passed, all superannuation funds will be able to comply within the time frame?

Mr Wyatt—What we are advocating is that the time frame is significantly too tight and that it is very difficult, if not impossible, to comply.

CHAIR—Or to calculate the reduced annuity?

Mr Wyatt—If they have to change the methodology to segregate and desegregate—and this is not my particular area of expertise; I do not work in that particular area so I cannot give you any first-hand experience of it—members of the Superannuation Centre of Excellence who are specialists in the area with very significant large corporate funds have said to me that it is an administrative nightmare. They have enormous concerns about the ability to be able to—

Senator SHERRY—I think you said that effectively it is a retrospective tax change on capital gains to 1988. Is that correct?

Mr Wyatt—Yes. That is absolutely correct because I, Murray Wyatt, who is 48 years old, cannot retire within the five-year time frame, therefore I am going to pay CGT from 1 July 1988 right through. It applies to the lot if you do not take the five-year window of opportunity. I represent a large portion of the baby boomers—so there is a whole block of us coming through who cannot, because of the legislative advantages with allocated pensions post-55, take advantage of those and cannot physically qualify within the five-year time frame. That is why we are saying that for those people who can retire within that five-year time frame it is concessional, but there is a greater population outside who will be paying a retrospective tax in relation to the change from the superannuation phase to the allocated pension phase.

Senator SHERRY—Finally, on the example that you—

CHAIR—Are you just following that argument through or is it a new issue?

Senator SHERRY—It is an issue relating to the retrospectivity of the capital gains. Based on the example that you tabled, under the example of Telstra 2, which is a case study—a share—with a valuation of 80c per share, you have 10,000 shares purchased and that is a reduction in value on the basis of your 80c calculation of 30 or 40 per cent. That is a very significant reduction.

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Mr Wyatt—Yes, and people will be more significantly affected in the Internet stocks, for example. A share like Solution 6, which is trading at \$2.80 today, has been a lot higher and people would have paid \$18 for it. So some people may want to remain in that share to give it time to recover. Because of the recent fluctuation in the stock market, this will be exacerbated depending on the share that is involved. If you do not have the hire of market or cost, there will be a significant disadvantage, both if the share goes up and/or in terms of the amount of CGT loss that can be calculated if the share goes down.

Senator SHERRY—I did have one other issue. Some superannuation funds own their own home and business property—which you have alluded to. Effectively, will that be caught by this new provision?

Mr Wyatt—Absolutely.

Mr Pragnell—There will be instances. If you look at the changes introduced under SLAA 4, under section 66(6) of the SIS act, where a small superannuation fund can own business or property—and that can even include, in some instances, the family home when it is located on land used in primary production—the capital gains that would be captured would stretch back. In Murray's instance, for somebody who retires in 2005 or 2006 you would be capturing 20 years of capital gains—

Senator SHERRY—On their own house?

Mr Pragnell—Yes.

Mr Wyatt—The capital gains will apply from 1 July 1988 through in my case. That is why it is particularly unfair to me and others.

Senator ALLISON—You have suggested a couple of behaviour responses to this bill—about how some people will try to retire before 2005 if they can. Will there be a shift away from DIY funds as a result of this legislation in your view?

Mr Wyatt—Small business people, from my experience—and I have been a practising accountant for a number of years—like to look after their own destiny. I would not say that there would be necessarily a move away from DIY funds. Most advisers would say either that this will apply to you where you can see it within a DIY fund or that it is lost in the numbers, because the income stream coming from the larger superannuation funds will be significantly reduced because of this. So you are going to pay it in a larger fund anyway. But what it does do is to make superannuation more complex, especially when you have a five-year window of opportunity. It just puts people under pressure to make those financial decisions which may not be in their personal interests in terms of what they want to do with their lifestyle changes. I do

not see that there is going to be a mass flood away from DIY funds because of this particular taxing, because it will apply to both situations, but it does complicate life for retirees.

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Senator ALLISON—In the attachment to a press release the other day—‘Super bill robs thousands to pay Peter’ or whatever it was—you gave some case studies. You gave the example of someone approaching retirement who has property valued at \$200,000 and will see a loss of \$33 gross a week in their pension. I just wonder whether that is a serious reason for retiring earlier than you might otherwise do, given that an earlier retirement, I would have thought, would reduce your prospects of income over time anyway. Just how serious a reason for early retirement is that?

Mr Wyatt—I would say that for those people who can take up the opportunity of that five years, because we are talking about the assets from 1 July 1988 through to 30 June 2000, it can be a significant component in the fund, depending on the asset structure of the fund. So it can absolutely be a significant reason to retire. It could make a considerable difference to your income streams. We have tried to keep this as a reasonably balanced example, but our practice has lots of examples at the other extreme where people are virtually going to have to go, because of the CGT application. In my particular case—for the people who cannot avail themselves of that and are caught—it will severely disadvantage me in my income stream, because I have had assets in superannuation in 1988.

Senator ALLISON—Apart from raising revenue, can you see any other motivation behind the bill?

Mr Wyatt—As a practising accountant, I am quite happy with all these changes.

CHAIR—So long as they get them right.

Mr Wyatt—Yes, so long as they will pay me. I can see a lot of disadvantages in the complexity, but on the other hand I am very glad for the accounting profession that there is this complexity, because it is what we do. In looking at it from the public interest point of view, it does make it quite complex.

CHAIR—In terms of retrospectivity, though, any tax change has a retrospective element. If we decide that as from 1 July we are going to increase the tax on the exiting amount on a pension, you might say, ‘That is retrospective because I entered into it on the basis of the lower amount.’ In relation to the changes to bring into account access to superannuation benefits from 55, you can say, ‘That is retrospective because when I entered my pension fund I thought I had that opportunity to retire without having to access pension benefits for the purpose of getting a supplementary pension.’

Mr Wyatt—The application is unfair because, if you were not born within that little five-year period, you cannot walk from the problem. That is why we are suggesting that you apply it across the board—

CHAIR—It is merely deferring the problem.

Mr Pragnell—Yes.

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Mr Wyatt—It is deferring the problem, but it is also allowing certain people who are born within a five-year period to not have the problem and yet I have, and I am—

CHAIR—You feel it is discriminatory?

Mr Wyatt—Absolutely discriminatory, about—

CHAIR—I think that is probably better than retrospective.

Mr Wyatt—It is also retrospective in that it applies to past gains. If you said to me we will value the assets today and we will apply CGT across the board to all those assets from 1 July forward, then that is absolutely equitable across all classes of people and it is applying from the valuation of that date forward. I am happy with that. But what it is doing to me is making me pay capital gains tax on my growth retrospectively to 1988 when, in my particular circumstances, I miss out by two years. There are people who will miss out by one day because of their birthday. I am not getting into retirement mode in terms of going to retire but, as my kids have left home, I am preparing to go into that phase.

What will happen is that I will be paying the CGT from 1 July 1988 right through. If you apply it forward from 1 July this year I have got no argument because it would be applied to all classes of people equally, not depending on when they happen to be born. The same thing applies, in terms of that window of opportunity, to people that miss out by very short periods of time. In relation to an allocated pension, the way it was before the press release, there would be people who turn 55 next Monday and could not avail themselves of that. You will always get that, but this is discriminatory and it is retrospective.

CHAIR—Thank you.

Senator SHERRY—I have another—

CHAIR—I do not think we can. You will have to ask another witness.

Senator SHERRY—It is not a question, it is just something that follows on from your comments. I could not help but read ‘retrospectively imposing a capital gains tax on the assets of many retired people that in good faith they believed 13 years ago they would deal with free of capital gains tax—the elderly of Australia have a right to be indignant about this change.’ Those were the Prime Minister’s words at the last election.

CHAIR—Can we keep those sorts of comments—otherwise we are just going to run into trouble with having witnesses when it is 12.30 and we will not be able to continue.

Senator SHERRY—Yes, we have to move on.

[9.12 a.m.]

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BROOKES, Mr Nicholas, Secretary, Corporate Super Association

CHAIR—Welcome. Would you like to comment on your submission?

Mr Brookes—I will just give a resume of our position, of what we are and what we are not supporting. Our position comes from the association being the representative body of approximately \$44 billion and 36 corporate funds in Australia which contain about 600,000 individual members of those schemes. It is important to underline that we are not coming from a position of seeking to make money from a product of super. The funds provide on a mutual basis, in a sense altruistically driven, benefits for members and their families during their working time and during retirement. The essence of that is very important.

What we are looking at in this current section of the whole bill is a move, which we are very worried about, towards increased cost and complexity which could ultimately end in two things: firstly, pensioners receiving lesser benefits in retirement; or, secondly, the corporate funds themselves deciding that it is unworkable and too costly to offer pensions and those pensions therefore will cease to be provided—and, again, the individual member, the individual pensioner, would suffer. I would refer to support for these arguments from the Institute of Actuaries of Australia and also Ross Stephens from KPMG.

The last point would be on the time scale which we are being asked to put into practice. Just suppose the bill were passed unamended, then we are looking at five days in order to implement what we regard as enormous and costly changes. Again, the detrimental effect of those changes to the pensioners would be forthcoming in time. So there are two aspects to this.

Senator ALLISON—I wonder if you could expand a bit on the proposals that KPMG have put forward for amending the legislation, which they say would have no revenue implications but which would be simpler to administer.

Mr Brookes—If I could just summarise those; the association is in support of the government's raising of revenue. That is not an issue with us. We support that. The method of it in terms of application of the proposals is detrimental to members. That is the area that we are having great trouble and difficulty with. KPMG's broad solution is that rather than physically segregate assets—and if you wish I will go into the problems of those perhaps on another matter—segregation of assets itself leads to difficulty, complication of administration, separate mandates, more legal fees, more tax consultant fees, more costs, more staff. I must underline here that in almost all cases the corporate super funds provide administration of the super funds free of charge to members. That is a critical point to emphasise. If we were making money from this, we could actually pass on that cost elsewhere. The consumer would pick it up. But here there is no money, there is no profit being made from this. That cost is actually a zero cost to members.

In terms of, therefore, satisfying the government's requirement to raise revenue—with which we have no disagreement; that is the government's choice—reconciling that with the ability to create a position where assets are not segregated, which is the current position, there is a

technique called, essentially, notional segregation. Instead of physically segregating, you create a notional basis of segregation. To a large extent that exists already under the current law, section 283, which is that the percentage of pension to the whole fund is then the formula for applying the tax deductibility of benefits from pensions across the whole fund. That is a sensible formula and it is backed up by actuarial estimates on the best estimate basis. All KPMG is saying—and this does need further discussion—would be that that basis of notional segregation really is in situ already. That could be continued. It probably needs to be refined. It certainly needs more discussion. I would like to say that the Institute of Actuaries also supports that notion, with a few technical refinements to it. Again, Senator Allison, if I may say to you that the time required to sort out these matters really—

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CHAIR—It is a proportionate method, is it?

Mr Brookes—Yes, it is. So it really could not be done in five days. It could be done in three months, sensibly.

CHAIR—What sorts of problems are you going to have in those three months?

Mr Brookes—If I could go back to it, the net result should be a win-win. The government should receive the same revenue that it would have received anyway, whether you segregate or do not segregate. But our proposal would be that the downsides to this bill are avoided. As an example, I have attached this table. We did a survey. Because of the shortness of time this had to be done very quickly. The survey of 31 of our major—well, they are all major—corporate funds on 5 June this year showed that 71 per cent of those members are paying pensions, which is interesting. What is particularly interesting is the percentage of pensioners to total membership. It varies from 0.1 per cent to up to, in one case, 40 per cent. But that is extraordinary. That is what you might call an outlying observation. The average is that just under three per cent of total members are actually pensioners.

In terms of assets I am just going to pick one by random, the second one on the list. They have 1,600 members in total and 220 of those are pensioners. They have \$300 million in the main fund and only \$8 million in pension liabilities. If we were to segregate, what you would have to do is to take out \$8 million from the whole, set up a whole new investment portfolio, investment mandates and try and somehow replicate the underlying investment strategy of \$300 million with \$8 million. I need not go on, actually, because that is a non-starter. But I will go on. Then you have to have your tax consultants' fees, your legal fees, complying and administration costs. So that is the scenario. That little example you could apply to all of these funds.

CHAIR—Can you table that?

Mr Brookes—Yes. That is the issue in a nutshell, practically.

CHAIR—It has been suggested that for some funds it is just not worth the cost because the benefits of doing that will forfeit the benefit of the capital gain. Is that likely?

Mr Brookes—I think it is possible but that is one of many factors which have led to the same conclusion. The conclusion I agree with. If the bill were passed without amendment the individual member in retirement would suffer. They would suffer since the corporates might well withdraw from providing pensions. They would suffer because if increased costs of providing pensions in retirement provided through corporate super schemes—and through industry funds as well that are similarly inclined; they are not for profit, they are looking after the best interests of their members too—are actually absorbed in the pension payment that means there is less pension which means—

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CHAIR—It would have to be, otherwise all existing members would be disadvantaged, wouldn't they?

Mr Brookes—In our case, perhaps, but may I just underline again that the corporates so far are actually paying the cost of administration, which is unusual. But they are doing this on a holistic mutual basis—remember that the SIS legislation actually encourages democratically elected trustees from employer and employee groups to make sure that members' interests are best represented. Any increase in cost is detrimental. But it is not just that—this is actually unnecessary increased cost. This can be avoided, which is the critical point.

CHAIR—It can be avoided providing you do not have to have the segregation of assets?

Mr Brookes—Precisely.

CHAIR—What sorts of initial costs would a typical fund have? Mercers, for example, indicate that that could discourage corporate superannuation funds from providing benefits in pension form, or it could even encourage trustees of corporate funds to dispose of existing pension funds by rollover or commutation options. Would your members be likely to do that? Is the cost such that they would move to that option?

Mr Brookes—Yes, it is cost and impracticability. It is impossible—actually unworkable—to employ the instructions under the proposed bill. I just refer back to trying to replicate an investment strategy from the main fund into a small fund. I would like to give you another example of that which is probably a slightly larger one just to show the size of it. A fund with \$6.3 billion has only got \$650 million in pension liabilities. That seems like a lot of money but relative to the whole it is not. In terms of actual pensioners, we have got in that fund approximately 3,500 pensioners from 52,000 members. The scale of actually setting up a separation of assets, just going through it point by point, will vary but certainly tens, maybe hundreds of thousands of dollars in this case, would be required because of the need to set up separate investment mandates, negotiate the mandates, set them up, lawyers would come in—I hope there are no lawyers here. The service providers would actually make handsome gains—a necessary evil, you might say.

Then there are the administration systems, the compliance systems, separate tracking and the staff required to actually implement, maintain and run those new systems. All are extra costs and extra requirements. Corporates generally are squeezed on the bottom line. They are saying, 'What is this for and is it worth doing?' Certainly in the case of—I will give you another one—somebody here with one member, one pensioner, they will be saying, 'Come on, how can we

justify that one pensioner out of 2,100 people?’ and that poor person would have to suffer. Or, in fact, they may well just provide it out of grace, out of goodness. Here are some more: one out of 3,400; 81 out of 47,000. So these are the practicalities of trying to segregate.

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Senator SHERRY—No-one seems to be disputing that the costs will increase. The corporates may decide: enough is enough, costs have gone up again, we have had to deal with the surcharge and other changes which have added to costs and complexity, therefore we will pass on the costs or alternatively get out of the product altogether.

Mr Brookes—Yes.

Senator SHERRY—And if they pass on the cost that means a reduction in the benefits to existing pensioners, doesn't it?

Mr Brookes—It does. Perhaps worse, too, is that if the corporates cease to provide pensions they will obviously cease to provide a growing area of pensions which are allocated. Seven of our members, very major members, have all put on hold the new introduction of allocated pensions for the same reasons. It leads on to two things, if I can reply directly to Senator Sherry's point: the increased cost means fewer benefits for pensioners; but, worse, increased cost and complexity mean that corporates would almost certainly pull out of provision of pensions, both normal pensions and, in the future, allocated pensions. The numbers at the moment are quite small. There are 600,000 individual members behind this, of whom at the moment we are talking about roughly 15,000 pensioners, but with the advent of allocated pensions the ability of these funds and industry funds to provide non-profit based funds is critically important. No bid offer spreads, no initial charges, no commissions, no ongoing fees, in our case no administration costs is a way of actually improving benefit in retirement to individuals. If they do not have those improvements, then of course they will have less, which means there will be greater reliance on the state. But there is a second point, which is the fact that it is probable, we think, that it will be an impetus to individuals not to take pensions. There will be a push to take the cash and run.

Senator SHERRY—So these changes are not going to be any encouragement to take income stream products in whatever form?

Mr Brookes—We believe not, and that is the surprising element of the bill in itself—maybe unforeseen, but still a surprise to us. We have built up a lot of trust over time with our members of the family, effectively, with the employees. As they retire they are trusting the funds to actually look after them in retirement, which is what our members do. But if corporates then say, ‘I am sorry, we just cannot provide any more of these pensions,’ a lump sum will most certainly be taken, we believe, by a majority of those potential pensioners with its nefarious consequences.

Senator SHERRY—You have recommended some changes but we have only got five days to go. It seems to me we are in an impossible position in practical terms. If you and others cannot reach agreement with Treasury and the government in five days on amendments that satisfy your organisation and others, are you saying to us we should defer this particular schedule of the bill we are going to consider in the Senate?

Mr Brookes—Very much so. I suppose that is our third choice. Trying to leave aside my Corporate Super Association hat for a second, it seems to be the most logical and sensible thing. Treasury are under enormous pressure to achieve a lot of things, not just here but elsewhere, and we sympathise on that. In terms of trying to get through the intricacies of this bill and to analyse the implications that have not been properly analysed, the most sensible, logical and decent thing to do would be to say, ‘Let us cut out this part of the whole thing, set aside a period of time’—we would say three months—‘and after the findings have been properly and exhaustively analysed, look to implement whatever that is in, say, 12 months time.’ That takes the heat off all parties concerned. The danger about not doing that is rushing into a poor decision with adverse consequences to individual members. I have to repeat, too, that the consequence on revenue to Treasury we believe is neutral, whether you segregate or not—we can certainly pay our way either way. That is not the issue.

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CHAIR—What do you think has motivated the change?

Mr Brookes—Originally the thinking was good thinking, squeezed by time with many things on the go. The change, and we are not saying it is good, was to say that at the moment there are parties in Australia who have substantial assets and pension liabilities and that the tax benefits from the investment income being tax free there under the apportionment method, applied across all the investments, could be—in fact, distinctly has been—of benefit to the shareholders involved in those enterprises. That is not our position, of course, because we do not have shareholders, we are not for-profit and nor are industry funds. So I think the move was driven by the logic of trying to stop loopholes in tax benefits, which is fair enough, and perhaps the unforeseen consequence of that is what we are looking at today.

CHAIR—As there are no further questions, thank you very much, Mr Brookes.

[9.31 a.m.]

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LORIMER, Mr Michael, Chair, Policy Development Committee and Director, Small Independent Superannuation Funds Association; and Associate Director, Managed Financial Services Pty Ltd

McDOUGALL, Mr Graeme, Chief Executive Officer, Small Independent Superannuation Funds Association

CHAIR—Welcome. We can only allocate half an hour. Thank you very much for your submission.

Mr McDougall—I would like to make a couple of opening comments and then pass over to Mr Lorimer to expand a little further. We would like to give you maximum time for questions. There are three words that I would like to put to the committee: retrospective, anomaly and discrimination. They seem to be the three words that come out in relation to this section of this bill.

I will deal with the amendments first. The proposed CGT amendments are retrospective. The amendments made in the House of Representatives on 20 June do not remove the retrospective nature of the CGT event. It is beyond my imagination how you could actually take away a retrospective tax, have a five-year window and then reintroduce it as a retrospective tax again. I have already heard here this morning one witness suggest that it is only going to privilege a few. I could not agree more.

The second point is this so-called anomaly. We have in place prior to this bill a policy that allows an exemption from CGT when assets of a fund are realised for the purpose of creating a pension. Some believe that that is restricted to small independent funds and that other types of funds miss out on that. I would like to suggest to the committee that that policy in its current form applies to all superannuation funds. It is a matter of the funds' choice as to whether they use that CGT exemption or not. Therefore, there is no anomaly whatsoever and there is no discrimination in the current policy—it is a matter of choice by the fund. With the introduction of the amendment which we have before us at the moment what we will see is discrimination because, in the majority of cases, small independent funds do not carry the cash balances within their fund investment structure that would allow them to finance a pension without having to realise some assets. On that basis, we actually build discrimination where it is purported there was before but there was not. There are many other issues that have come out this morning that I would like Mr Lorimer to expand on, but we would like to start on those three points.

Mr Lorimer—I can only support Graeme's opening comments, obviously. The starting point from our perspective is to go straight to our recommendation to the committee today. Our primary recommendation is basically to leave the current tax provisions, so far as they relate to the exemption from income tax on pension supporting assessments, as they currently operate. In our view, they operate effectively and efficiently, and equitably across all classes and manners of superannuation funds. In formulating that recommendation, we should also pose the question: why is there really a need for this specific component of this legislation right now if we are likely to have broader superannuation reform later this year? Surely, it would be much

simpler and more logical to withdraw the superannuation measures from the schedule of this bill and wait for further reform. We consider that superannuation funds should be, and can reasonably be expected to be, excluded from the provisions of this legislation. Quite clearly, they can be distinguished from the business of life assurers and other like bodies.

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Graeme has spoken about the recent amendments, and I can only endorse his comments there. From a practical perspective, so far as it relates to complying superannuation funds, large and small alike, effectively the bill can be divided into two broad categories. The first category contains measures that provide the means or the method by which the income derived by pension supporting assets remains exempt from tax. So that is the first category of measures. The second category introduces this new deemed notional capital gains tax event. Effectively, so far as these measures apply to complying superannuation funds, that is how this legislation works.

The first category, dealing with the method by which that income tax exemption is achieved, quite clearly purports to deal with the business tax reform recommendations. I will talk about this further, but our view is that it is a very clumsy and inefficient approach. The second category of measures, the new deemed capital gains tax event, was not included in the business tax reform recommendations so we can only conclude that it has been inserted to address a perceived mischief or loophole—and I emphasise ‘perceived’. The perception has been—and I will reiterate Graeme’s comments—that the current ability of assets in pension phase to be disposed of without capital gains tax has been unique or limited to small superannuation funds, and that is just simply not the case. Any comments in the debate on this legislation to date in that regard can only be held as very misleading and not reflective of the current situation.

There is no loophole to close and therefore the imposition of this new notional capital gains tax event is the introduction of a new tax. You cannot look at it in any other way. The first category of measures dealing with how income derived from pension supporting assets is determined to be exempt does not remove expensive costs—and I refer to fact sheets released from the Department of Treasury some time ago. They said that the new methods proposed do not remove such costly and complex allocations of income and expenditure. That was one of the intentions of this component of these measures. But as this legislation currently sits—and witnesses preceding us endorsed this view—that was hardly the case. Far from it. It will not reduce or remove costly and complex allocations of income and expenditure. These measures, as they currently sit, will escalate costs and complexities. There is no question about it.

Managed Financial Services in Brisbane look after some 3,000 superannuation funds ranging from self-managed superannuation funds to public offer super funds. For your typical small superannuation fund that is required to segregate its assets under these measures, we can quite conceivably see that average small fund in that category going close to doubling its annual administration, accounting, audit and compliance costs—close to doubling—because the requirement to segregate assets effectively means that the superannuation fund must notionally divide itself into two or more subfunds, and each one of those subfunds must have its own investment strategy, and payments of the pension must be drawn from the segregated component. So from an administrative perspective the fund, to the extent that it is required to segregate assets, will effectively be operating as many funds as there are pension components. That result can hardly be said to enhance competitive neutrality—and that was one of the other broad statements of intention in the introduction of these measures. Quite the contrary, it put

small—and probably all superannuation funds, for that matter—at a competitive disadvantage in this regard.

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I will go back to our original recommendation that these measures, so far as they apply to superannuation funds, be either dropped altogether or subject to a much broader review. That is on the basis that the current proportionate approach to the exemption from income tax for pension supporting assets is an efficient, effective and equitable operation of the policy intention. We would welcome any questions from the committee.

CHAIR—Coming from the small business sector, with a lot of your members wouldn't one of the assets be a matter of investing in the business, in a sense?

Mr McDougall—If you go back to December of 1999 with the change to investment rules for small funds, we had a change that allows the investment of up to 100 per cent of the assets into the fund into business real property, which could not, in effect, be one property. If you take a scenario of three members and you want to segment that property for the purpose of two staying in an accrual stage and one going into a pension stage, I think it is pretty easy to see where this legislation is taking that sort of issue.

CHAIR—The reason for my question is that if a person continues that business for 15 years and retires, they get a very significant reduction in capital gains tax. This new system is going to wreck a lot of that, is it not? Why would you want to do that if you are going to lose the benefits on retirement of a huge capital gains tax change? You do not get those changes now if you put it into a super fund, do you? Given all the valuations that are going to be required—

Mr Lorimer—I see what you are saying. I cannot disagree with what you are saying in principle. The capital gains tax issue in this legislation certainly has received and attracted the most attention. I think our biggest concern with that measure is that it is impossible to find where it emanated from. Our only conclusion is that it can be based on this perception that there was this loophole that was being exploited in superannuation funds, which is clearly not the case. The policy has been in place for 12 years. I would have thought that, if it was that clear a loophole and it was being exploited to that extent, it would not be 12 years down the track that it has first been identified and finally being addressed. The policy when the 15 per cent tax on superannuation funds was introduced with effect from 1 July 1988 so far as it related to funds that then commenced to pay pensions was to ensure that their normal assessable income became exempt from tax. Taxable contributions were not included in normal assessable income, nor was non-arm's length income or special income. Normal assessable income, effectively, is all investment income, which includes capital gains.

Going back to some comments that Graeme talked about, the recent amendments do nothing for the retrospective element of this legislation. All they do is just defer this problem for five years. There has been discussion that in relation to that five-year window this legislation will only tax the capital gain accruing up to 30 June 2000 or 2005, or whatever it is. But from an income tax perspective, capital gains for tax purposes do not accrue over time. A capital gain occurs when an event, typically disposal of an asset, occurs. It is only at that time that this notion of a net capital gain becomes income under the law. It does not accrue. As markets go up and down, the value of an asset goes up and down. A capital gain will not be required to be

brought in as assessable until that event happens. Things do not accrue in a capital gains tax regime. It is not appropriate to say that a gain has accrued over a certain period of time.

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CHAIR—So all those small firms that have invested 100 per cent into the super fund are going to lose the threshold, the \$500,000. They will lose the 50 per cent concession CGT because of the new changed regime.

Mr Lorimer—Because it is in the fund?

CHAIR—Yes. Previously it did not matter because there was no CGT, but the CGT is going to make these whole things suddenly captive to tax.

Mr Lorimer—Correct.

CHAIR—And in the future discourage anybody from putting their business into this form. So you have two problems.

Mr Lorimer—It is totally discouraging.

CHAIR—You have some inconsistency there, haven't you? You have encouraged these people to go into funds as a result of SLAA 4. Those who had some of their businesses in this area had the advantage of \$500,000 and a 50 per cent CGT exemption. Now, because of the valuations that are going to apply, they are suddenly going to be subject to capital gains tax in the fund which would not have been subject to tax if held personally. So a whole lot of businesses will want to try to exit their businesses from the superannuation fund very quickly and put it back into a personal form. That will be one of the first consequences any tax planner would want to make. Is that correct?

Mr McDougall—I would agree with that. May I add another comment?

CHAIR—I am just trying to think through the scenarios.

Mr McDougall—Yes, and can I add another point to the public policy position on this issue. One of the objectives back in the time of setting up the policy was to encourage people, in their long-term savings plan and in their long-term income plan, to take a pension rather than to take a lump sum and double-dip. The sorts of changes we are seeing here today are going to reverse that totally. If that is in the interests of what we are looking at in the ageing population and the so-called baby boomers then I think this whole scenario is taking a monstrous step backwards.

Senator SHERRY—It seems to me that there are two broad and strong criticisms. We have been talking about the issue of effectively a retrospective tax change. Do you agree that it is a retrospective tax change in respect to capital gains tax?

Mr McDougall—That is the amendment? Yes, absolutely.

Senator SHERRY—On that issue: some DIY funds own their own businesses and their own houses, as I understand it, within the DIY fund. Are you aware of that? We had some discussion about it earlier.

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Mr Lorimer—If you are talking about the measures that came through as a result of SLAA 4 back in December, yes, there is the ability for small funds to acquire business real property—which, in the case of farming businesses, will include the home.

Senator SHERRY—So when the capital gains tax is applied, it can apply to those forms of property as well within the fund?

Mr Lorimer—Yes.

Senator SHERRY—I cannot think of any other circumstances where capital gains tax applies to your own home. Can you think of one?

Mr Lorimer—No.

Senator SHERRY—What we have got here is a proposal which will catch some homes in the capital gains tax.

Mr McDougall—Yes.

Senator SHERRY—The other set of complaints is about the administrative complexities. You obviously agree that this increases complexity, cost, admin, et cetera. Do you agree with that?

Mr Lorimer—Yes.

Senator SHERRY—You referred earlier to doubling the cost of administration. Can you give me some idea of the range of the costs at the present time?

Mr Lorimer—I will limit my comments to a small self-managed fund. Those sorts of funds' administration, audit and compliance costs under the current regime would probably—and I can only talk from the perspective of a managed financial group as an administrator—range from \$2,000 to \$2,500 per annum. Under these measures, a fund that has a pension member and a non-pension member—which will now under these proposals be required to segregate the assets supporting the pension fund—will now be operating effectively a superannuation fund as a taxpayer, but underneath that will be the subfund, with all the pension assets for which you are probably going to have to set up another bank account to ensure that your pension payments are coming out of the right section of the fund. Every year you are effectively going to have to make sure the assets are valued to ensure that there is not too much sitting in the pension side, et cetera.

Running through the numbers in a couple of scenarios, we would expect those typical costs between \$2,000 to \$2,500 to double. It would be more like \$4,000 per annum. It flows through.

There is the administration side of things. You must carry out these administrative functions to work out the correct amount of tax to pay at the end of the year. So then there are the income tax issues at the end of the year and then, arriving at that result, the fund must be audited as well, so it is going to be a concern for the auditor to make sure that these assets are sitting in the right part of the fund. So it is a very convoluted and complex process and it can only result in increased costs.

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Senator SHERRY—These changes cannot add to a system that wants to encourage retirement income streams—it can only detract from that policy.

Mr Lorimer—Yes, I can certainly endorse that view from hundreds and hundreds of our clients, following the introduction of these measures.

Senator SHERRY—Can you give me a rough estimate of what proportion of DIY funds would be affected by this change? Is it a half, a tenth or are we talking about most?

Mr Lorimer—That is a difficult question to answer. If you look at the number of funds currently paying pensions versus what that is going to be in five to 10 years time, certainly from our client base the number of funds going from the accumulation phase now and over the past three years to the pension phase is snowballing. People reaching that stage of life are starting to look after themselves. It is fair to say that the current number of funds paying pensions is not insignificant, and it will become more and more significant as more funds, large and small, begin to turn accumulated assets into pension supporting assets. So it would be a growing problem.

Senator ALLISON—I would like to go back to the statement in your submission that to say that this is a measure that affects only DIY funds is misleading and completely erroneous. Can you fill that out for us? Our briefing notes, for instance, indicate that the measure was designed to create neutrality between small self-managed funds and other super funds. Under the current rules small super funds have an advantage, as they are not subject to tax on capital gains on conversion while complying super funds are subject to tax on capital gains at concessional rates of 10 per cent. Are you saying that that is not right; that this measure will change all funds everywhere in this respect?

Mr Lorimer—Yes. The current regime, to provide an exemption from income tax in respect of those assets that support pensions, applies to all complying superannuation funds. With regard to the exemption from income tax, of course net capital gains become income when an event occurs and so the exemption applies to investment income, including net capital gains. That is available to any complying superannuation fund in Australia at the moment, whether it has 100,000 members or one member.

Senator ALLISON—What do you think of the suggestion made by the corporate super funds about notional capital gains? Is that workable?

Mr Lorimer—I think ‘notional segregation’ is the term. The proposal put for notional segregation was effectively talking about perhaps refining the current regime of this proportionate approach. We would endorse the proportionate approach, and if it requires some

refinement, or tweaking—whatever you want to call it—then we would support that. Certainly, from a practical perspective, the current tax law gives superannuation funds paying pensions a choice: they can either segregate their assets or apply the proportionate approach, which requires an actuary to determine what percentage of the assets of the fund on an average basis are supporting pension payments. So there is a choice there. From a practical perspective, and certainly from a small fund's perspective, the proportionate approach is the choice made, simply because to choose to segregate the assets, as I have already discussed, is far too costly an exercise. It is more efficient in administration and cost to appoint an actuary each year to tell you what the proportion of your fund's income is exempt from tax than to physically have to segregate the assets.

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Senator ALLISON—Would that system work with DIY funds and corporate funds?

Mr Lorimer—Yes, all funds alike.

CHAIR—How often would a pension fund require the services of an actuary nowadays to do that valuation? Do they do it every year, every three years or every five years?

Mr Lorimer—It depends on the nature of the fund. For small superannuation funds where all of the members are in receipt of pensions the requirement to engage an actuary can be every three years. Where you have a superannuation fund that has one non-pension member in it, and the assets are not segregated—which in most cases is the situation—the requirement is for an actuary to provide that certification every year. It is for the purpose of completing the income tax return effectively. It is a very quick, simple, efficient exercise with clear results.

CHAIR—So for the purpose of this exercise, for what category of funds are you going to have to employ an actuary every year as opposed to every three years?

Mr Lorimer—It is immaterial what category of fund it is.

CHAIR—Yes, but some are already employing an actuary every year so you are suddenly bringing in a new category of superannuation funds that will be required to employ an actuary every year.

Mr Lorimer—Under these measures?

CHAIR—Yes, just name them for the *Hansard* record.

Mr Lorimer—Sorry, I am missing your point, Chair.

CHAIR—It will now be necessary for all funds to employ an actuary once a year to do a valuation. For certain categories of funds they now have to employ an actuary only every three years.

Mr Lorimer—The funds that will be required to appoint an actuary every year now are those funds that are not paying an allocated pension effectively, simply because an actuary will be

required on an annual basis, in the case of non-allocated pensions, to value the current pension liabilities of that fund to ensure that there are no more or less assets segregated for the purposes of the income tax exemption. What that means is that each year the actuary will need to perform this valuation. If earnings are poor in a particular year, the value of the pensions at the end of the year will be greater than the value of the pension assets at the end of the year, resulting in a shortfall, so assets will need to be transferred into the pension pool.

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CHAIR—You mention about transferring assets from the pool into the segregated assets, but if you have got an accumulation fund for the others would it not be the business that would have to top it up, otherwise you are taking from your accumulated members? Your accumulated member liability is known, so if the actuary does his job and finds there is a shortfall, unless you have got some sort of surplus in the accumulation phase you would require a drawdown from the company, wouldn't you?

Mr Lorimer—Not necessarily, because the notion of segregation is simply for income tax purposes. The proposal is to ensure that the assets that are earmarked, so to speak, for supporting a pension, if it is 50 per cent then it must remain at 50 per cent, and if their notional value goes up—or down, as the case may be—for income tax purposes, the result has to be 50 per cent still.

CHAIR—But could an auditor allow you to draw off the accumulation phase to put it in notionally, when it is known? If it is actually known I should think it would be bad auditing practice to permit that. You say it is just for income tax purposes but, at the end of the day, if you keep on going along this line and there is a bit of a crisis, your members will come back and say, 'Why didn't you top up the fund, as required for the pensioners? Why should we have suffered?'

Mr Lorimer—That is a conceivable outcome. There will be audit difficulties. We have already established that.

Senator SHERRY—Just two quick points. I think you did say you could not find these changes recommended in Ralph—it would take a highly imaginative inventive person to find these recommendations, and so far all the witnesses have said they cannot find it.

Mr McDougall—We can find no evidence of it in Ralph.

Senator SHERRY—Finally, how do you want this schedule in the bill treated? I assume you do not want it passed. Do you want it withdrawn and then some sort of commitment given that you will take care of the problems further down the track? You want this schedule withdrawn and dealt with at a later stage presumably?

Mr McDougall—That is the position that we have had right from the start. We believe that it should be withdrawn from the bill. Either it can be dealt with separately, as some other witnesses have suggested, or we believe that if we are going to see a review of retirement income policy, as has been suggested, then it would be preferable to make it part of that review.

Senator SHERRY—Just on that issue—I note you did comment on that—there have been a number of comments by the Treasurer, not just in his budget speech to the Press Club but on previous occasions, that superannuation would be subject to some sort of review, and then when pressed on the detail of when this review would take place we do not have any. Do you have any response to that?

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Mr McDougall—My only response to it is we have in this country at the moment a retirement income policy that was designed a long time ago in basic structure; it was designed when most people departed not long after they retired, particularly in the case of males; and it is hardly a policy that actually reflects what is now required in retirement income. I think all political parties have suggested that people should be making arrangements for their own retirement and to be less dependent upon the public purse. If we do not review the current retirement income policy then we are not going to overcome this position that we are in, and we should be looking at the future rather than looking at the past. So, is there a need? There is an absolute need to carry this out.

Senator HOGG—Do you have any idea of the likely impact on the retirement income of people as a result of this initiative?

Mr McDougall—At the moment we do not in exact figure terms. But let me suggest to the committee that we have not seen any figures either to support the argument that has created the bill as it stands. In other words, what is the income gain for the government? What—

Senator SHERRY—We cannot find it, by the way, in the brief.

Mr McDougall—We cannot find it. What is the benefit from or the reasons behind this legislation? If it is revenue based then one would assume that there has been some modelling done to understand what is the income going to be received by government, what is the loss to revenue from a lower income tax perspective if a pension is reduced, and what is the impact of an increase in age or other social security benefits that pension recipients might be able to have. If we could see that modelling we could understand, or have some semblance of understanding, what is driving the need for this legislation, but those figures, to my knowledge and to our knowledge, are not available.

CHAIR—Senator Kemp will be here at twenty past ten. We have received a submission from a gentleman in the audience. We can give you 10 minutes, sir, if you would like to come to the table.

[10.09 a.m.]

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RAMSAY, Mr Mervyn Ross, Managing Director, Bramex Pty Ltd

CHAIR—Welcome. Is there anything you wish to say about the capacity in which you appear?

Mr Ramsay—I have appeared before you before, at the superannuation surcharge hearing. I am the Managing Director of Bramex Pty Ltd, a small company which has a DIY superannuation fund. Our submission, No. 12, is a very short submission. Would you like me to go through it?

CHAIR—Just give the highlights of it and then we will ask you questions.

Mr Ramsay—We are making this submission because we feel this is the imposition of yet another new tax. As said by other speakers, it is an inequitable tax impacting particularly on particular classes of people fairly randomly—those near retirement and, as we have heard from earlier witnesses, those quite a long way off too. The previous submission from SISFA was excellent in raising the issue for small funds and I support 100 per cent everything they said.

To address the policy framework of superannuation now, it is said to encourage self-funding—that is, that people should fund their own retirement to the degree that they can instead of relying on the taxpayer. That core principle is very hard to reconcile with the proposed amendments in this bill. As far as self-funded pensions go, they are automatically devalued by the GST. This is not a criticism of the GST, it is a plain statement of fact because the government's estimates are that price levels will rise by perhaps two or four per cent. That is meant to be offset by income tax cuts, of course. But what will happen in the case of these self-funded retirees is that the value of their pension will fall in real terms by that two to four per cent for a start. Other pensions are automatically compensated for this; all other pensions are funded by the taxpayer. They are either the age pension, which is getting a one-off rise of four per cent, or they are public sector pensions, which are earned, for example, by public servants and members and senators, and they are protected by indexation. So all those other pensions, taxpayer funded, will automatically rise in real terms or at least in terms which compensate for these effects. These pensions—that is, self-funded pensions—will fall in real terms.

Given the background that there is a fall already, as other speakers have said: where is the rationale, what is the rationale, for this new impost? It is to rectify an anomaly, perhaps. That seems to be the implication because the subject matter of the relevant section of the bill is all about life insurance companies which are only very distantly connected to DIY funds. One very important point raised by the previous witnesses is that there is 'supposed to be' an anomaly. There is only an anomaly if those large funds choose to make it so, if they choose to take a certain course of action. They are completely free to take the same course of action as DIY funds. So, really, there is no anomaly being addressed.

On the effect of this proposed tax, Senator Sherry particularly has asked questions about the actual value of the fall. This will affect different people in different ways, depending on the composition of the fund. I could give you a very simple example that you could comprehend in

very simple mathematical terms. Let us say, in round figures, there is \$100,000 which is being converted to a self-funded pension and half of that is capital gains—\$50,000. The \$50,000 will be taxed at 10 per cent, therefore \$5,000 will go to the government, so the \$100,000 that you had before becomes \$95,000, which is a simple, straight, five per cent reduction in the self-funded retiree's pension. That is pre the other effects that I mentioned which could be, say, four per cent. So the self-funded retiree beyond 1 July, in that simple example, is looking at a nine per cent reduction in real value of their pension. Of course, \$100,000 is not even enough to fund one partner in a retired couple at the old age pension level. To fund the old age pension, a capital sum of at least \$200,000 is needed.

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CHAIR—Would you like to break there because we do have a deadline. You have got the option of continuing and there will not be any time for questions, but if you would like some questions, perhaps we could take five minutes. I will leave it to you.

Mr Ramsay—Thank you. I will follow your course of action; I have made the key points.

Senator SHERRY—In terms of the fund that you are involved in, will any of the members of your fund be helped by these changes?

Mr Ramsay—Absolutely not.

Senator SHERRY—They will all suffer a decline in income on retirement of varying degrees depending on the make up?

Mr Ramsay—Absolutely, because a portion of the fund will be subject to capital gains and therefore the capital sum will be reduced.

Senator SHERRY—And this is a retrospective capital gains application, isn't it?

Mr Ramsay—Absolutely. The members of the fund have been saving in super for more than 40 years. The assets saved earlier have been moved into the DIY fund, so, as an earlier submitter said, that will be taxed from mid 1988.

Senator SHERRY—In the case of your fund, does the sponsoring employer pay the administrative costs of the fund or are the costs debited against the members' accounts while they are in the fund or ultimately when they retire?

Mr Ramsay—The company pays the costs of the fund's administration but the effect is the same, because the members are also shareholders in the company, so the bill comes home to roost with the same people.

Senator SHERRY—So this does not simplify superannuation in your case at all but just adds to the complexity, cost, administrative burden, et cetera?

Mr Ramsay—Yes, I think it is extraordinarily complex. DIY funds are surprisingly complex to administer even now because of the depth of the legislation and the number of rules.

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Senator ALLISON—Has your fund got property?

Mr Ramsay—No, it does not have property. It does not have real property, it has financial assets. We decided that it was too hard within that framework to administer property because of some of the reasons that you heard earlier, so ours are all financial assets.

CHAIR—Thank you very much for attending today and also for presenting at very short notice.

Mr Ramsay—Thank you for slotting me in, I appreciate the opportunity.

[10.20 a.m.]

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KEMP, Senator the Hon. Rod, Assistant Treasurer

REGAN, Mr Anthony Clive, Assistant Commissioner, Law Design and Development, Large Business and International, Australian Taxation Office

CHAIR—Welcome, Minister.

Senator Kemp—Thank you. I will have to make a fairly quick exit but I am always happy to help the committee, as you know, and to deal with issues that come before it. Let me make a number of observations. I will start off with an opening statement if the committee is happy with that.

CHAIR—We can give you as much time as you can give us.

Senator Kemp—You are very kind. I have probably got 20 minutes. The Treasurer's announcement on 21 September on the new business tax system outlined changes to the taxation of superannuation funds flowing from changes to the taxation of life offices. The objectives of these changes are: to treat the pension business of super funds consistent with the annuity business of life insurers and to remove a CGT anomaly from the tax system. These measures should be taken in the perspective of the beneficial changes that this government has made to pensions and annuities so that they are more attractive to retired Australians.

From 20 September 1998, income streams that provide an income for life or life expectancy, or 15 years where life expectancy is greater, are exempt from the assets test and a wider class of retirement income stream products qualify for the more generous pension Reasonable Benefit Limit. These measures have proved very popular. Probably we do not get enough press as we should on that, but my understanding is they have proven to be very popular and I am waiting for a question from Senator Sherry in the parliament on these issues.

Senator SHERRY—Very popular—too popular, even.

Senator Kemp—Well, that is interesting.

Senator SHERRY—That is why you are trying to whack them over the head.

Senator Kemp—Too popular—it is a bit of a worry that Senator Sherry said that. In addition, as a result of the new business tax system, members of complying superannuation funds will benefit from: complying superannuation funds receiving refundable imputation credits—and that is seen to be a very important plus; a 10 per cent tax rate on capital gains compared with the 15 per cent currently; the continuation—and I underline this—of the 15 per cent superannuation pension rebate; and continuation of deductions for the purchase price of pensions or annuities.

These overall benefits have been acknowledged by superannuation experts—for example, Daryl Dixon. I do not agree with everything that I will be quoting from Daryl Dixon, but for the

sake of completeness and so that I will not be accused of gilding the lily here, this is what Daryl Dixon, an acknowledged expert, said:

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He went on to say—and I do not agree with this, let me tell you:

While retirees have every reason to be suspicious of the motives of any government generosity, the—

and I underline this—

extremely favourable treatment of allocated pensions is a tax bonanza for retirees.

Let me make this comment: that came after the announcement that has been the subject of one of the matters before this committee. The anomaly being addressed by the bill I think is acknowledged by the industry. I know it is not acknowledged by everyone and I have had indications this morning that some people do not agree with this.

Senator SHERRY—No-one agrees with it so far.

Senator Kemp—Let me just give you a quote, Senator Sherry—you are getting very aggressive for a Monday morning! Tony Negline, Chairman of the Australian Retirement Income Streams Association, was quoted by Peter Freeman in a *Bulletin* article on 16 May and this is what he said:

The ability of DIY funds and some master trusts to avoid paying [capital] gains tax when an allocated pension was commenced has always been a bit of an anomaly.

Peter Freeman also said in that *Bulletin* article:

Graham Horrocks, a private superannuation consultant, agrees—

that is, with Tony Negline's comments—

but adds that there have been cases in which some individuals have been able to avoid paying very large capital gains tax bills by using the previous arrangements. 'I can't imagine it will deter anyone from taking an allocated pension, given the tax concession they enjoy'.

'A tax system redesigned' proposes that these objectives would be achieved by taxing complying superannuation funds on the income derived on assets supporting pension business and giving them a deduction for the 'interest' component of pensions paid. As a consequence of concerns raised during those consultations after the Treasurer's announcement, this method was modified from that originally proposed. However, this did not affect the tax impact of business tax reform measures as originally announced.

Under the modified approach, assets supporting pensions and annuities that have commenced payment will be segregated into a separate asset pool. Income derived from assets in that pool will continue to be exempt from tax. In response to a number of concerns raised by the industry after the introduction of the bill, a number of amendments were made to address technical problems and to provide clarification.

Also, in response to industry concerns, I announced on 20 June 2000 transitional measures for DIY funds affected by reforms to the tax treatment of capital gains for complying superannuation funds when converting from the accumulation phase to the pension phase. As a result of these consultations—and there was some press on this—the government adopted the proposal put forward by ASFA on this matter. The transitional arrangements will allow members of self-managed funds who are within a few years of retirement to continue with their current retirement plans and give sufficient time for other members to adjust their retirement plans, having regard to the new measures. The transitional arrangements have been limited to DIYs, in line with ASFA's proposal, because the proposals impact on DIY funds to a greater extent than on other funds, as DIY funds typically hold assets for a long period of time—that is, they do not turn over assets on a regular basis.

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I think there was some concerns in some quarters that when we announced the modification and the transitional arrangement for the DIY funds there was an expectation that at the same time we would also announce the solution to this problem. I acknowledge that there was some disappointment in the industry that we were not able to do that. The reason was not any foot dragging on our part. The reason was that is a very complex issue. We wanted to make sure that any solution to it was widely welcomed by the industry. We do not want to solve someone's problem and give a detriment to another group in the industry. I put that on the table.

I am aware that there have been calls to have the aspects of the bill which impact on super funds delayed. That would not only have a significant impact on revenue but also create great uncertainty. We are concerned to make sure that this bill proceeds. We are mindful of issues that have been raised by industry, particularly the last matter that I mentioned. We have dealt with that effectively by picking up the ASFA proposal on the transitional arrangements that were applying to DIY funds. Although that has not been universally welcomed, I think most would regard that as a very practical and sensible measure.

CHAIR—We certainly welcome further consultations with a view to working out a method which will have a more acceptable outcome. Minister, given that there is only short time in which to implement the proposals, what is your advice to people? Should they go away now and value their assets—because some will want to do that in the knowledge that the bill is in the parliament and that, if we pass the bill, they will have to do that? What is your advice to businesses? Should they go away, value their assets, segregate their assets, or what should they do in the meantime?

Senator Kemp—What I am putting on the record is the government's intention to see what we can do to deal with some of those concerns. If we can reach a rapid solution which, hopefully, would have a general consensus approach by the industry, the government would make an early announcement. But that is dependent on our reaching a solution. I think we can reach a solution—and I might ask Mr Regan to comment—but I want to make sure a solution that will address the issues of one particular sector of the industry does not cause a problem elsewhere.

CHAIR—I think industry does need an answer to this, because they are likely to be going out, valuing assets and making segregations. I think they do need some sort of guidance.

Senator Kemp—Perhaps I will get Mr Regan to comment.

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Mr Regan—Under the bill, funds have until 1 October to segregate assets, with effect from 1 July. The bill also gives the Commissioner of Taxation the ability to extend that period if need be. We could still be looking at alternative solutions, but we would certainly seek to have them resolved before then. There is a fair degree of time before funds do have to segregate assets, with effect from 1 July.

CHAIR—So you are suggesting no valuations and no segregation until the government makes its announcement? This is the question that is on everybody's lips.

Mr Regan—It would up to the fund as to how it wanted to proceed. A lot of funds, effectively, are segregated currently. For example, if the fund is only carrying on pension business, effectively, it is currently segregated.

CHAIR—There are not too many of those, though. They generally fall into the life category. Most of them have very few pensioners, and this is the difficulty they are facing in terms of cost.

Mr Regan—Certainly one solution we have been looking at in respect of the sorts of issues that have been raised is an alternative method for working out the exempt income. If the fund has only a small number of members, that is the type of fund you would expect to use the alternative approach. I would have thought that type of fund would probably wait to see what the outcome is.

Senator SHERRY—But ultimately, the law, if passed as proposed, would require segregation?

Mr Regan—The law, if passed as proposed, would require segregation with effect from 1 July, but funds have until 1 October to actually do that.

Senator SHERRY—Yes, but it would still require segregation. I think those are the two main concerns. There is the revenue issue, which we will come to, and there is the cost of doing this. It is not just DIY funds. It is large corporate funds and industry funds. There is a cost to doing this. Would you agree that there is an additional cost?

Mr Regan—Certainly, there is a cost, particularly with the initial segregation. Once the initial segregation is done, the ongoing costs are expected to be a lot less. But there is no doubt that there is a cost with the initial segregation.

Senator Kemp—Let me make the point that we may well have to look at an optional arrangement so that those who do not want to use the segregation process can have other options. It is very complex, I have to say. In developing the original proposal, we consulted very extensively with the industry. Correct me if I am wrong, Mr Regan, but this approach, as I think I mentioned, came out of consultation with the industry.

CHAIR—What sectors of the industry principally?

Mr Regan—Under the tax system redesigned, the new business tax system, we had this assessment deduction regime announced. In developing that there was consultation with industry. The main party from the superannuation industry who displayed an interest in that were ARISA, the Australian Retirement Income Streams Association. They argued very strongly to move away from that deduction approach, simply because that was going to result in more complexities than what we see here. The Institute of Actuaries was also involved very heavily in the consultation process. Other sectors in the super fund environment were consulted, but for one reason or another did not display as much interest in it.

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Senator SHERRY—They did not agree with you—that is the blunt fact of it.

Mr Regan—They did not express a view one way or another.

Senator SHERRY—You have heard the views expressed here this morning. There is not one organisation, even ASFA, that apparently agrees with the administrative complexity of what is being proposed. There is not one.

Mr Regan—They were given an opportunity to be involved in the consultation process.

Senator SHERRY—I understand that, but can you name one of these organisations that agrees with what is being proposed?

Mr Regan—As I said earlier, there are quite a few funds where the segregation approach effectively applies. The current law has a segregation approach.

Senator SHERRY—That is not the question, Mr Regan.

Senator Kemp—I know that. There are people who come before this committee and put a view, and we do not resist that at all; they are entitled to do it. Of course, people who have concerns tend to be those who come before the committee. There are some, as Mr Regan says, for whom this will not cause problems, but there are others who feel that it might. I have indicated the willingness of the government to work with them to see whether it is possible to deal with their concerns. That is what I am flagging to the committee. I also flag to the committee that we will seek to move as rapidly as we can. But it depends in the end on not only getting agreement but getting agreement across a broad spectrum of the industry that may be affected. It may be that the solution is to provide an alternative method so that those in the industry that are supportive because they already do it—have their assets segregated—may presumably continue to use that approach.

CHAIR—There is another issue apart from segregation. In SLAB 4 you provided a very generous 100 per cent investment in premises. Now that there is capital gains involved, why would somebody want to put their business assets in a superannuation fund because it is now going to be subject to capital gains tax whereas if held personally there are very generous concessions? There is a \$500,000 limit, there is 50 per cent, et cetera. Are not these people going to be disadvantaged as a result of the government's encouragement to put 100 per cent of their assets into a superannuation fund just last year as compared with the current situation?

Senator Kemp—That was a measure that was very widely welcomed. It was a good measure. But during the accumulation phase it is subject to capital gains tax, if it is sold. Equally, if it is rolled over into a lump sum—and Mr Regan can correct me if I am wrong—it is subject to a capital gains tax. Capital gains tax has always been there as a result of the 1988 measures.

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CHAIR—What I am saying is that we are now getting a roadblock, to put it that way, in terms of encouraging people because of what applies personally as opposed to putting it into a superannuation fund.

Senator Kemp—I think a lot of people are still seeing there are a lot of concessions available by using superannuation funds. That was a lot of the debate. The truth of the matter is that in the accumulation phase a capital gains tax applies.

Senator SHERRY—Minister, there is one thing I am puzzled about. What is the revenue gain from this measure, because I cannot find it in the explanatory memorandum? What do you gain each year?

Mr Regan—The explanatory memorandum explains the revenue gain from the package of measures as a whole.

Senator SHERRY—Yes, I know, but what about this measure?

Mr Regan—If this measure were to be withdrawn, my understanding is that the revenue impact would be in the order of \$70 million.

Senator SHERRY—Per year?

Mr Regan—I think that is right, yes.

Senator SHERRY—Effectively, Minister, when you were referring earlier to Daryl Dixon's quote about the additional tax bill, there is an additional annual tax bill of \$70 million per year on superannuation funds that are affected by this.

Senator Kemp—But, on the other hand, we have provided a lot of other concessions. What Daryl Dixon—

Senator SHERRY—I do understand that.

Senator Kemp—I want to make it very clear that you can pick out one particular element of this and say that it is a concern, but when you look at the overall effect of what we are doing in the reduction of capital gains tax and the refundable imputation credits, I think we are providing substantial benefits as well, plus the concessions which are there. People will have different views, but let me say that Daryl Dixon seems to be a very strong supporter of the system in place for pensions and annuities. He sees these as being very tax advantaged. He thinks there are great incentives for people to put their money into these products.

Senator SHERRY—Where does it recommend in the Ralph report that this increase in taxation occur on superannuation products, because we cannot find it, and none of the witnesses this morning could find it within the Ralph recommendations?

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Senator Kemp—I will ask Mr Regan, who was involved with that, to answer the question.

Mr Regan—The Ralph report says that the method for working out the amount of income that super funds are not taxed on in relation to pension business would be changed from an exemption method to an assessment and deduction method.

Senator SHERRY—You claimed that that clause represents the provision that we are considering. That is what you claimed.

Mr Regan—That is right.

Senator SHERRY—We have had a lot of experts before us from corporate super, small independent super funds and the CPA—these are all independent experts in the area and there are more to come—who just do not agree with that view. They cannot find it. Why do these experts say they cannot find it and you say that it is there in Ralph?

Mr Regan—It is certainly implicit in the statement in Ralph. I would agree with you that that is not stated explicitly in Ralph.

Senator SHERRY—Is it agreed, Minister, that in certain circumstances for a small fund where the property is owned by the fund—a do-it-yourself fund—some of those properties would be subject to capital gains tax as a result of this change?

Senator Kemp—As a result of the measures that were brought in in 1988, where a certain property is held directly it is exempt from capital gains tax. Where it is held indirectly through a superannuation fund, it is subject to capital gains tax. These measures were brought in in 1988 by the previous government.

Senator SHERRY—And you are extending this to the tune of \$70 million a year in capital gains tax.

Senator Kemp—Let me make it very clear to you. This is one of the measures that are being brought in. There is a whole range of measures which affect superannuation. The reason that we have indicated this—as I said earlier in my remarks, and Mr Regan has made some comments on it—is that the idea that you might have been putting is that this is a significant change when, in fact, the measures of the previous government—

Senator SHERRY—I am not putting that; the witnesses are putting that.

Senator Kemp—In that case, I welcome the chance to make that point.

Senator SHERRY—To the tune of \$70 million a year.

Senator Kemp—I have heard that you have been pressing this very hard, Senator, so I am very pleased to be able to put it on record.

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Senator SHERRY—Yes, I have. It is a \$70 million a year tax change—an additional tax burden.

CHAIR—In 1998 when the capital gains tax was introduced for superannuation funds, they were allowed the higher of the cost or the market, as I understand it. This legislation provides for a market valuation. So there are detrimental consequences if that option is not replicated in the legislation before, which I understand it is not, it is valued at market. For example, using the Telstra shares, Mr Wyatt, a witness from the CPA this morning, said that the lack of that option could cause some problems for members of superannuation funds. Is it an oversight that the government did not include the higher of cost or market, as they did in 1998, because that would seem fair, whereas there could be consequences whether you make a profit, or even if you make a loss down the track, by not adopting that? A typical example is the lower value now of, say, the Telstra shares. Could that be accommodated?

Mr Regan—The issue is only relevant for the transitional measure.

CHAIR—Yes, that is right.

Mr Regan—This links back into the capital gains tax provisions. I would have to double-check whether or not it has the effect of picking up the cost base or market value, whichever is higher.

CHAIR—The new one does not, the old one did.

Senator SHERRY—So if the old one is not in there, you can change that?

CHAIR—You would give consideration to changes?

Mr Regan—Yes, we would certainly need to consider that.

Senator Kemp—I will take that one on notice. I actually have to run, unless there is any super urgent question that anyone wants to put to me.

CHAIR—Senator Hogg?

Senator HOGG—No.

CHAIR—Senator Sherry?

Senator SHERRY—There are lots of super questions I would like to put to you.

Senator Kemp—I said ‘super urgent’ questions. I know you have a lot of super questions.

Senator SHERRY—One last point. You did say, Senator Kemp, in respect to the administrative complexity that you hoped to work out a solution, and you went on to say, ‘This is a complex issue.’ You are accepting that there is an increased administrative burden and cost associated with this.

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Senator Kemp—Some groups have come to us and indicated that. Others, of course, currently segregate issues and they are comfortable with it. Others have come to us and asked us to look at this further. I have indicated that I will look at this further. I have further indicated that if we can reach a satisfactory solution which does not have a detrimental effect on other sectors of the industry, we will see what we can do.

CHAIR—That would be welcome, Minister. Thank you very much. It is very generous.

Senator SHERRY—Is Mr Regan staying?

CHAIR—I presume he will be a witness.

Mr Regan—I will be staying here.

CHAIR—We always encourage departmental officers to be present.

Senator SHERRY—Is he staying as a witness?

CHAIR—No, not as a witness. Minister, thank you.

Senator SHERRY—Just before we have morning tea, I understand the minister had to go and he gave notice of that, but we have Taxation Office officials here. This is a \$70 million hit on super and we would like some more detail about where this \$70 million is coming from.

CHAIR—One of the big problems, Senator Sherry, is that the minister has agreed to take on board a lot of the issues that have been raised today.

Senator SHERRY—What does that mean?

CHAIR—Well, we do not know.

Senator Kemp—It is being recorded by Hansard. Senator Sherry is taking advantage of issues here. It is most like you, I must say, Senator Sherry.

Senator SHERRY—My job is to probe, question and query these disastrous super changes.

Senator Kemp—Senator Sherry, you have said every super change is a disastrous super change—

Senator SHERRY—Under your government they have been.

Senator Kemp—and yet super continues to grow at very healthy rates, Senator Sherry. Let me make that point.

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CHAIR—Is it the wish of the committee to forgo the morning tea break?

Senator SHERRY—Yes. I think if we have Mr Regan here we should keep asking questions.

CHAIR—He cannot answer any questions in relation to what the government is planning. That is the difficulty.

Senator Kemp—I am here to answer questions in relation to what the government is doing. I have provided plenty of time to do that. I would have preferred to provide more, but this has come on at fairly short notice.

Senator SHERRY—That is because we only have five days to consider the bill.

Senator Kemp—If you have any other urgent questions you would like to put on notice, we will see what we can do to set you straight.

Senator SHERRY—It will be a long committee stage in the Senate, that is all I can say.

Senator Kemp—I look forward to that.

CHAIR—We might have to look at that later. The committee stands adjourned for a very short morning tea break.

Proceedings suspended from 10.49 a.m. to 10.59 a.m.

NEGLINE, Mr Anthony Francis, Chairman, Australian Retirement Incomes Streams Association Ltd

CHAIR—Welcome. Because of the fog problems and the delay to aircraft and non-arrival of witnesses we have had to alter the schedule. We are now calling on Mr Tony Negline from ARISA. It may be necessary later on in the morning to have a number of teleconferences if the planes are not able to land.

Mr Negline—Would you like my opening remarks?

CHAIR—Yes.

Mr Negline—In ARISA's view, one of the key issues that the Senate must consider is the consistency issue that very similar types of outcomes are available by different legal structures. One of the good things that the Senate did back in 1998 was that all parties agreed to the passage of legislation which dealt with consistent treatment for all different types of retirement income streams, whether it be pensions or annuities, for social security income and asset test assessment. As I said, all parties agreed to that. It provided a consistent treatment. That change has been an unmitigated success and it has been a success for no other reason than the fact that it provides for consistent treatment and it is simple.

ARISA is strongly of the view that an overriding principle of any change that is made must be that it applies consistently across superannuation products, whether they be provided by life insurance companies, friendly societies or superannuation funds. ARISA represents all different types of providers of retirement income streams, whether they be DIY funds, public offer funds, master funds or industry funds and also life insurance companies, banks, friendly societies, credit unions and so on.

I would like to acknowledge the fact that when these changes were created, the government—in particular the Treasury and Tony Regan—did give us a chance to pass comment on the policy issues. We were given the chance to have good input. A lot of our ideas were, hopefully, taken on board. There was a good, open consultation process and I would like to thank the government for that opportunity.

Once the legislation had been released, ARISA asked specifically for four issues in detail to the government. They gave us two of those issues. They gave us a third issue and we got 50 per cent of what we asked for. The fourth issue we asked for was consistency. Unfortunately, the issue of consistency has been put to one side for a moment because of the CGT changes for DIY funds.

As I said, ARISA has always believed in consistency. The way the CGT system works is that it is designed to provide CGT in a number of circumstances. The main circumstance is in the issue of deferral where you are moving from the accumulation phase to the pension phase and CGT is deferred. The amendment that has been put through the House of Representatives by the government operates in such a way that the record keeping needed to run that makes it

extremely complex. You get, if you like, an exemption for assets that you purchase after July 2000 but not a deferral mechanism for assets that you purchase before then. Perhaps the rationale for that is that the deferred mechanism would have been too hard to run with assets especially if you start an income stream after that date. Really the issue is that the system is somewhat complex. Perhaps there is an easier way to handle these things.

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The other point that we need to bear in mind as well is that some of the amendments that were made by the government in the House of Representatives only apply to superannuation funds and those amendments relate to the inclusion of the capital gains tax for the valuation of liabilities that can sit within the segregated pool. That needs to be brought into line for life insurance companies. The government has allowed the Commissioner of Taxation flexibility in the time frame that they are allowing superannuation funds to adjust to this new system but that flexibility has not been afforded to life insurance companies. We would like that ability of the Commissioner to provide an element of flexibility to be provided to life insurance companies. They are my opening remarks.

Senator SHERRY—We heard from Treasury that the approximate revenue gain to government from these changes is \$70 million per year. Did they tell you, in your consultations, that that was the revenue gain?

Mr Negline—No, they did not. Any knowledge we have had of revenue estimates has been contained within the Ralph report, the government's *Not a new tax, a new tax system* document and also within the EM. It says in the EM that \$200 million is a global tax take or additional tax take for schedule 2. We did not ask for a split-up of that, so that is the first time we have known about that.

Senator SHERRY—Where is this proposed change contained in the Ralph report, because the previous witnesses have said they cannot find it?

Mr Negline—Everyone is entitled to their view, but my own view is that it is contained within Ralph.

Senator SHERRY—Where?

Mr Negline—It is contained within Ralph where it talks about the change to the taxation treatment of like economic transactions being treated in the same way. It does mention the fact that superannuation fund taxation will alter in line with the taxation changes to life insurance companies, so that annuities and pensions would in effect be taxed in a similar manner.

Senator SHERRY—So the impact of that is that the level of annuity or pension that a person receives will decline.

Mr Negline—Certainly based on the Ralph reforms that would have probably been a likely outcome.

Senator SHERRY—If there is \$70 million coming off the base on which annuities and pensions are paid, it must decline, mustn't it?

Mr Negline—Yes, on the whole.

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Senator SHERRY—Yes. And that is not including the costs of administration and those sorts of issues that are the other major criticisms.

Mr Negline—Yes—you have got two issues there. You have got the additional cost of administration—whether it be compliance cost and so on and so forth—and you have also got additional tax take, so yes.

Senator SHERRY—On the tax take issue of the \$70 million per year, it has been argued by all the witnesses other than Treasury that there is retrospective change to capital gains tax in this measure. What is your view of that?

Mr Negline—You would probably have to argue that with an asset that was purchased and is then now on deferral going to be subject to CGT, depending on how you argue what retrospective means, if the asset has been purchased and it was not subject to CGT and now on disposal it is, I guess you would have to argue that there is a retrospective nature to it, yes.

Senator SHERRY—Back to 1988?

Mr Negline—No, really since purchase.

Senator SHERRY—Since purchase, so you are saying prior to 1988?

Mr Negline—Potentially so, yes.

Senator SHERRY—I have heard figures suggested of a significantly higher tax take than \$70 million. Can you give us any view on that?

Mr Negline—No. ARISA does not have a view on what the tax take will be overall. There is a body of opinion that says that the government will collect a reasonable amount of revenue out of this. Of course, dollar figures have not been provided on that. It is very hard for the industry to get together. These issues are very complex. We have had, in detail, a very short period of time to assess them. So industry is trying to implement the changes for the start-up date. When you are trying to rush through implementation, you are often not making estimates of how much it is going to cost your business. You are implementing it and then you are working out the effect.

Senator SHERRY—In your submission and your comments you have referred to increased administrative costs in a range of things—and that is true, isn't it?

Mr Negline—Yes, without doubt.

Senator SHERRY—Let us assume the bill goes through unaltered in the next five days, is it possible to implement these changes in the time required?

Mr Negline—I think there is a concession to require things to be done within 90 days, or longer if the commissioner allows for super funds. As I said in my opening remarks, that additional allowance is not allowed for life insurance companies. It is possible to implement these changes, hopefully, within 90 days.

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Senator SHERRY—Hopefully?

Mr Negline—Hopefully, yes. Some funds will find it difficult, some others will not. Certainly our members have, if you like, accepted the need for segregation and are currently working on it behind the scenes. Other funds—other members—would have difficulty.

Senator SHERRY—The minister has alluded to ‘hoping to work out a solution; it’s a complex issue.’ Wouldn’t it be better to know, before 1 July, what the law is and what the actual formula is on which the calculations have to be done?

Mr Negline—I think in an ideal world it would be nice to know things, say, 12 or 18 months before they actually take place. One argument would be that we have known about these changes, they have been coming for some time, we just did not know what their content was, so you cannot do anything until you know the content. In my view, the government probably provided the information to us in as quick a time as they could possibly get to it, which is unfortunately not leaving us much time to deal with these issues.

Senator SHERRY—The minister himself effectively accepts that they might change something more. He has referred to ‘hoping to work out a solution.’ If you are going to work out a solution, surely there has got to be change to this legislation?

Mr Negline—Yes, and I guess it depends on what aspect of the legislation. If it is a few tweaks here and there, that is fine, but if it is a major fundamental change, then that is an issue. I guess it depends on how deep the government are thinking at this point in time.

Senator SHERRY—We will see how deep they are thinking. Wouldn’t it be better if this matter were simply withdrawn and dealt with, with the industry, over the next few months rather than forcing it through this week? Do you want this forced through this week with the current timetable?

Mr Negline—We would prefer to see it passed, yes.

Senator SHERRY—In the current form?

Mr Negline—With a couple of minor issues that we have raised, yes.

Senator SHERRY—But if the government does not address your so-called minor issues, do you want it passed?

Mr Negline—We would like you to consider our amendments as well so, hopefully, they might have a chance of getting up.

Senator SHERRY—If there are not the numbers in the Senate to change the government's proposal, what do we do?

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Mr Negline—We would like the legislation to begin so that we know where we are going.

Senator SHERRY—Can you give us any specifics about the additional costs in administration?

Mr Negline—No, it is very hard. Really it comes down to the system that you are running now and your administration processes. Certainly anything that requires you to keep more records is more costly in terms of data storage; you have compliance risk; you have more likelihood that, in the event of tax audit, you get things wrong, and so on. So you do have an increasing cost. How much that is, is going to depend, as I said, on your systems, how many members you have got and the types of assets your fund is holding right now. A lot of DIY funds, for example, hold their assets in term deposits and cash funds, so you could actually argue that they do not need to do any work at all because they do not have any CGT issues.

Senator SHERRY—But we know a lot of funds do have to do a considerable amount of work.

Mr Negline—Sure, absolutely. In actual fact, there is an inverse proportion between the level of knowledge that a member has to have about this information and the amount of work that needs to be done. I can tell you that life officers absolutely have an enormous amount of work that needs to get done in order to implement these changes, whereas, without discounting the amount of work that a DIY fund has to do, a DIY fund has less work in comparison to a life company, and you could argue it is simpler.

Senator SHERRY—You say 'simpler'; let us take up that word. The impact of these changes is more complexity, more administrative change and cost. You agree with that?

Mr Negline—Yes, I do.

Senator SHERRY—It just puzzles me that, aside from the revenue gain, which is fairly obvious, the Treasurer has said that superannuation is too complex and needs reform and review. He has said that on a number of occasions. This makes it more complex, harder, less easy to understand and more costly.

Mr Negline—Yes, I agree with that.

Senator SHERRY—Why should we consider legislation like this without first considering the overall reform of superannuation if the goal is, in fact, to make it simpler and less complex?

Mr Negline—I guess you would need to then say, 'If we're going to have a review, what would it contain?' And then you would move forward from there.

Senator SHERRY—In the meantime we add to the complexity and the difficulty?

Mr Negline—That has happened in all sorts of situations.

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Senator SHERRY—I know that. We had the surcharge debacle and we have now got this. If a government wants to have a review to simplify, to remove complexity, to reduce costs, why add to complexity and cost in the meantime?

Mr Negline—I do not know—that is a government issue.

Senator SHERRY—If \$70 million is the minimum figure—I am led to believe it is higher—it is a very significant change to capital gains tax treatment of superannuation funds, isn't it?

Mr Negline—As a percentage basis I am not 100 per cent sure what the dollar value of assets in pension funds—

Senator SHERRY—For those who take annuity products?

Mr Negline—Going from zero to something is always potentially significant. At a global percentage level I guess you could argue that it is not that great, but the fact is it is still something.

Senator SHERRY—But it is the impact on the people who are affected that is important.

Mr Negline—Indeed, absolutely, I agree with that.

Senator SHERRY—This does not affect everyone in the superannuation sector.

Mr Negline—I agree.

Senator SHERRY—Thank you. We have had this submission from Bramex Superannuation Fund and their estimate of the impact depends on their shareholdings, when they were purchased, whether they contain property and those sorts of variables. In the case of Bramex, it can be 10 per cent of the value and that is significant for those individuals.

Mr Negline—The cost is 10 per cent of the value of the assets?

Senator SHERRY—No, the impact will be 10 per cent—a 10 per cent reduction in income payments.

Mr Negline—Each trustee and each life insurance company would have to determine how they pass that additional cost through to their pensioners and annuants.

Senator SHERRY—But the bottom line is that the cost we pass on will be a reduction which varies depending on individual circumstances?

Mr Negline—Indeed, yes.

CHAIR—Unless in the case of corporates they fund it themselves.

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Mr Negline—Yes, and I would have thought that for corporate funds it would mean either additional employer contributions or additional administration expenses passing through the funds somewhere along the line.

Senator SHERRY—To the member?

Mr Negline—To members.

CHAIR—Wouldn't that make it less attractive for the corporates to provide pensions, particularly where the pension is only a small component of their total in terms of numbers and invested amount?

Mr Negline—I guess that really, to some extent, that would be a situation whereby the employer and the trustees of the fund would have to assess whether it is economically viable to do that. One of their options would be to provide those same income streams through other mechanisms.

CHAIR—Such as?

Mr Negline—Such as public offer funds and so on. So they could use a life insurance company to provide an allocated annuity.

CHAIR—They could use one of ARISA's products.

Mr Negline—One of our member's products, indeed.

Senator SHERRY—Why should they be forced out of their existing structures into some new structure at additional cost? Why should they be forced to do that because, effectively, of a tax penalty?

Mr Negline—I was providing a solution; I was not trying to justify the change.

Senator SHERRY—No, but effectively that is what happens, isn't it? It forces them into another product at greater cost?

Mr Negline—I suppose the option is that if a fund decides that it wants to provide a benefit, presumably it looks for the most economical way to provide that—or the trustees would hopefully do that. Therefore, regarding the most economical way, if you are saying, 'I provide it myself,' or 'I provide it through a life insurance company,' in the initial instance, providing it through, for example, a life company—not only a life company—would presumably be a little bit cheaper.

Senator SHERRY—Why?

Mr Negline—You have got economies of scale. You have got administration costs to bear, and so on.

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Senator SHERRY—You have got fees and commissions and charges. Have you added those into the formula?

Mr Negline—To some extent we are fighting at shadows really here, aren't we?

Senator SHERRY—We are not fighting at shadows. I have people who come to me who have got a lump sum they have taken out of their industry fund or their corporate fund. They go off to a life company and they invest the money with some sort of financial adviser, agent or whatever they call themselves and they have to pay a significant charge for that, too, don't they?

Mr Negline—There is often a fee and/or commission for advice, yes.

Senator SHERRY—Often? I would like you to show me an example where there is not a fee or a charge—that is just nonsense. Why should people be effectively financially penalised and forced out of corporate and industry funds to take up the services of another provider where they have to pay an additional cost?

Mr Negline—There is not only the issue of creating these changes to administer the tax changes; there is also the whole infrastructure to ensure pension payments are made. Trying to put all that into play is not necessarily a cheap exercise.

Senator SHERRY—Yes, but a lot of them are doing it anyway. A lot of these corporate funds and industry funds are providing this service gratis or at very minimal cost. Why should they be forced out of providing that service by these absurd administrative changes?

Mr Negline—I am not suggesting that they should be.

Senator SHERRY—That is the effect of it.

Mr Negline—Potentially, yes.

CHAIR—That is a debating point.

Senator HOGG—Have you done any modelling on the impact on funds of this legislation?

Mr Negline—No, we have not done any modelling. When we were given a chance to provide consultation and so on, we spent many hours contemplating how the legislation was going to affect not only super funds but also life insurance companies and the flow of money that travels around the accounts of both a life company and a super fund.

Senator HOGG—Contemplation is one thing, and we all sit and contemplate from time to time, but modelling is a definite technique that can be used to look at the impact of initiatives such as this. People such as me are very interested in organisations such as yours, which would

have a number of customers who are going to be affected by these changes. I would have thought that you would at least have had some mathematical analysis, some modelling, done of the impact of this particular initiative. Otherwise, contemplation gives the big tick without anything to back it up. I want to see the evidence.

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Mr Negline—The way this legislation affects people is this: there is almost a different effect for every potential retiree. So trying to come to a definitive position for everyone is, unfortunately, almost impossible.

Senator SHERRY—We do know it is detrimental.

CHAIR—Just to sum up: what are your two changes, very quickly?

Mr Negline—I will address the capital gains tax: one of the things that could be contemplated is maybe making a slight amendment to the introduction of the CGT change—giving it to everyone but having a start-up date for the CGT transfer mechanism of 1 July 2005. In other words, you remove the excluded fund amendment that has been proposed now and you say, ‘The deferral mechanism will have a start date of 2005.’ That is the first thing. We would like to see the commissioner given discretion to provide a longer period of time for a life company to establish these changes. We would also like to see life companies being allowed to include the deferred CGT liability in their exempt asset pools. Instead of two, I have given you three issues that need to be addressed.

CHAIR—Thank you, Mr Negline.

Senator SHERRY—Chair, while Dr Anderson is coming to the table I will put a question on notice. I would like Treasury modelling of how the \$70 million per year is raised in respect of the capital gains tax changes and, secondly, Treasury modelling of the long-term impact of this on retirement incomes, that is, the pension retirement incomes mix. I put that on notice in the hope that we will have that by the time we debate this in the chamber.

CHAIR—The last question would depend very much on the method of the delivery, wouldn't it?

Senator SHERRY—It does, but I presume that, like everything, these significant changes are modelled in terms of their impact. There is a retirement incomes modelling group, and you would assume that Treasury would ask these fundamental questions on such a significant tax change.

CHAIR—I am not trying to be difficult but I just point out that Corporate Superannuation indicated their costs differed quite considerably depending on whether they have got one pensioner in relation to 10,000 members or 500 members. I was just wondering if you could be a little bit more specific.

Senator SHERRY—Treasury must have some assumptions to come up with \$70 million a year. They must have some assumptions. We would like to see how that is modelled and what the assumptions are; and, secondly, if they have done this, what the long-term impact of this

change is. If there is a reduction in income streams and annuities pension products what is the impact on the government pension? What is the impact on social security? There must be a downside as well as an upside for government in terms of revenue. I would assume those sorts of commonsense thoughts and policy analysis are made. If they are, they can tell us. We would certainly like to see where the \$70 million comes from.

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CHAIR—It also depends on how they hold their assets. Treasury may be able to do that, but it will be subject to number of assumptions, Senator Sherry.

[11:26 a.m.]

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ANDERSON, Dr Michaela, Director of Policy and Research, Association of Superannuation Funds of Australia

CHAIR—Welcome.

Dr Anderson—I would like to make a small opening statement. Listening to Senator Nick Sherry I thought he had taken my argument, which is that this, in fact, points very clearly to the need for major tax reform; that we are again fiddling around the edges of tax and superannuation. I recall that when fund taxation was introduced in 1988, a Labor initiative, the CGT provisions were applied to all funds' assets irrespective of the date of acquisition. There was no 1985 cut-off date as occurred with other entities. The implementation of that 1988 change was a major flaw but it had a minor flaw as well, which was that the CGT was expected to be payable by all funds, but certain funds seemed to be able to escape it. This CGT evasion issue has long been acknowledged within the industry as an unintended consequence that advantaged one section of the industry. At some stage we all knew it was going to be changed. The proper way to change it, though, is not to do what we are doing now but to look at the whole question of taxation of superannuation, particularly at this accumulation phase.

Having said that, ASFA has welcomed the amendments to the bill, which provide some transitional relief for self-managed funds and small APRA funds in regard to the transfer of assets between the accumulation and pension paying phase of such funds. A balance is needed when you look at the reasonable expectations of fund members, particularly those intending to retire in the near future. This transitional arrangement is in line with methods suggested by ASFA for achieving this, although if somebody can find a better method for the transitional we would be quite happy to consider that.

The problem with the bill, it seems to me, is that we are trying to do several things here in relation to tax—some which seem to affect small funds, some which seem to affect other funds—and it is all extremely complicated. As ASFA understands it, the bill had its genesis in concerns about small funds avoiding payment of capital gains tax which accrued during the implementation phase and with life companies overestimating the assets and income attributable to current pension businesses. We believe that was the reason given. Accordingly, the legislation should focus on achievement of these objectives, if that is what it wants to do. Where possible, the impact on superannuation funds should be considerably removed.

Carving out superannuation funds with less than one per cent of total assets in current pension assets is an improvement on the original proposal, but we cannot see why you need to have only closed funds within that. However, ASFA suggests that the bill be amended to carve out from it more provisions where there is no avoidance of CGT in the accumulation phase or where there is no overestimation of income attributable to pension paying. No tax can be avoided in arrangements where an allocated pension is established by the receipt of an ETP or other amount of money as opposed to the transfer of an asset. This relates to both CGT and ongoing income. ASFA recommends that the proportional method be permitted to be used in relation to such arrangements.

Segregation of assets and the accounting and other procedures required by the bill would result in an expensive compliance burden for many corporate funds offering life pensions but not able to benefit from the de minimus rule in the bill. ASFA recommends that a formula method be designed as an option for such funds. Such a formula could be based on an actuarial standard for calculating pension liabilities, with the application of a standard assumed earnings rate on assets for determining exempt income.

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Timing of the proposed changes is a concern. While the provisions are clear enough for self-managed funds, particularly given the transitional arrangements, and for life companies, it would be unfair to expect other superannuation funds to comply within the timetable proposed. What I have found most interesting in all of this is that often, when a bill is put out, a lot of the large service providers come out with an interpretation of it. What I have not seen this time is an interpretation of it. I really think that is because it is so difficult for people to say what on earth it means for superannuation funds. The cynic in me might say that they might know what it is but that they can see it is going to be a real little revenue earner for them trying to explain it to funds. Either situation is not a good one for fund members.

I have also been somewhat unsure, to say the least, of what it does actually mean for funds. We talk about segregation of assets, but when I talk to people in the tax office and look at some of the stuff they are putting out for their staff, I see that this is not a physical segregation of assets, which is what a lot of people are assuming, but that they keep using the words that it is only 'an accounting exercise'. When I ask, 'What do you mean by 'an accounting exercise'? Explain this to me.' I get a less than satisfactory answer. I do not think they know what they mean by the term.

Terms, generally, within this are another problem. We have had this question of how to segregate them on a proportionate basis—and I forget the words that are used—but they do not seem to give very many clues as to how you might do that. I am not suggesting that we want a hard and fast definition that ties everybody down, because that is probably not going to be in the best interests of most funds. I think all of this really shows that the time provided is definitely inadequate for funds to comply, even though they have the three months to understand it. It seems to me that there is a lot of work needing to be done and that if there were any chance of it just not happening, that would be in the best interests of everybody.

CHAIR—The minister addressed the committee earlier and indicated that he will have further discussions with the industry. It appeared that it was essentially centred around the question of segregation of assets, although other issues were raised, including the high cost, or market issue, of the short-term five-year transition period. In light of that, what is your recommendation to the committee? Do we proceed? In a sense, there is a problem for people. Do they go out and start valuing and segregating assets? That may not be required. I am trying to anticipate the potential outcome of the discussion between the industry—and I should imagine that ASFA would be involved—and the government.

Dr Anderson—The uncertainty is a huge issue, in that people just do not know what to do. It would be much better if you could just say to people, 'Hold everything; we have not got this right. We are going to have another look at it.' I have first-hand experience in the kinds of problems that it causes, in that I am the director of a reasonably small corporate fund attached to

a university. It is closed to new members. It is half and half—pensioners and still active members—and we are really considering whether now is the time to wind up the pension phase of it, because the segregation of assets for us is an extraordinarily complex and costly issue. I have to admit we had always contemplated that there would be a time when we would purchase annuities when the contributing members began to wind down. But we brought that notion forward at a special meeting recently to see whether it is time to do it now. There were a number of issues on why we might do it now, and this was certainly there. So we have had first-hand experience of what it is doing, and the uncertainty was a real issue for us.

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Senator SHERRY—I think the minister conceded that it was a complex issue. With reference to the administrative difficulties and the complexity, he said, ‘We hope to work out a solution.’ But wouldn’t it be better if we had a final solution in legislation so that everyone knew where they stood—or hopefully knew where they stood—rather than passing this section of the bill?

Dr Anderson—I am not quite sure I follow you.

Senator SHERRY—The minister is accepting that it is complex and difficulty. He is indicating that they will continue to work on that. In the meantime, we are asked to pass this section of the bill. Wouldn’t it be better to put this section of the bill on hold until those consultations are completed and people are satisfied that the administrative complexity is minimised?

Dr Anderson—Yes, I agree with that entirely.

Senator SHERRY—Thank you. With regard to the revenue issue, we heard for the first time this morning from Treasury of \$70 million a year in additional capital gains tax in this area. We also heard—and the chair very correctly questioned the application of capital gains tax in this case—that the base for the purposes of calculation is different from when the changes were made in 1988; that the way in which shares are valued is more adverse. Do you have any comment or response to that issue?

Dr Anderson—No.

Senator SHERRY—It has been pointed out to us in evidence that the changes to CGT in this area are not consistent with the changes that were made in 1988; that they have a worse impact.

CHAIR—If the market value is below your cost at 1 July 2000. But if you have not considered it—

Dr Anderson—We have not considered it. It is probably another example of badly thought through legislation which follows on from other badly thought through legislation. That is what we are experiencing here, which is why we have the mantra of ‘Let us look at the whole tax system again.’

Senator SHERRY—From all witnesses so far, including the last who wants this legislation passed—although not with the amendments, by the way, which I found interesting in terms of

your submission—we have heard arguments that the capital gains tax changes are retrospective, prior to 1988, and that, in some circumstances in DIY funds, property, including a person's own home, will be brought into the tax net. Do you have any comment on that?

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Dr Anderson—Somebody should sit down and work through what happened in 1988. I am not sure whether I am on the right track here, but there was no provision made for the 1985 cut-off—everything was then subject to tax.

CHAIR—For super funds?

Dr Anderson—Yes, for super funds. If that is your starting point, what is worse? I am not sure.

Senator SHERRY—But the government is gaining an extra \$70 million a year, at least, from this measure, as we have discovered.

Dr Anderson—Yes, it would be.

Senator SHERRY—Can you show me in the Ralph report where this is detailed?

Dr Anderson—I am sorry, I could not do that.

Senator SHERRY—Most other witnesses could not either.

CHAIR—Except the chap from ARISA.

Senator SHERRY—I said 'most other witnesses'. This is an increased tax take in respect of some people in superannuation; bottom line, \$70 million in revenue. Do you agree? Where was this increased tax take in respect of superannuation specified in the lead-up to the last election, for example? I certainly do not recall any reference to this.

Dr Anderson—No, but it has been acknowledged by the industry over the years that there was a section of the industry which was not as caught up in the 1988 tax changes as others were. The 1988 tax changes were completely the wrong way to go anyway, but that might be the reasoning that is sometimes in Treasury's mind when they are looking at this area.

Senator SHERRY—I do understand the Treasury approach, but prior to the last election we heard these words from the Prime Minister:

... retrospectively imposing a capital gains tax on the assets of many retired people that in good faith they believed 13 years ago they could deal with free of capital gains tax. I mean the elderly of Australia have a right to be indignant about this change ...

It was Labor's proposal to remove the tax-free capital gains component prior to 1985. This is the Prime Minister's view. Do you have any response?

Dr Anderson—There would appear to be some inconsistency there, but there are inconsistencies throughout the taxation of superannuation.

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Senator SHERRY—I understand that, and you have a very sympathetic listener here. You are right; we have an inconsistency. This tax change, this increased tax take, was not detailed prior to the last election by the government, and it was not detailed in Ralph. Isn't that a further reason why this matter should be put aside for further consideration?

Dr Anderson—It may not have been detailed there, but it has probably been on the minds of Treasury for a very long time.

Senator SHERRY—I accept it has been on the minds of Treasury, but politicians supposedly call the policy shots. Governments implement policy, not Treasury, I hope—although I have my suspicions on this issue. You are here addressing government and opposition politicians; what do you ask government to do?

Dr Anderson—Generally, we would expect some indication of policy to go in front of legislation—yes, I would agree with that.

Senator LIGHTFOOT—Dr Anderson, you said words to the effect that the only way to change is not what we are doing now, but to look at what we do badly and change the legislation—in other words, take a retrospective look. What did you mean by that? Did you mean that it wants a comprehensive review?

Dr Anderson—Yes.

Senator LIGHTFOOT—It wants a comprehensive review?

Dr Anderson—The taxing of superannuation needs a comprehensive review. We are getting into yet another bit of complexity here. I think we could stand back and fix the whole thing. Yes, I can see some inconsistencies with the way 1988 changes were made, which somebody might want to patch up and it might have a good revenue outcome. But it seems to me that that is not really the way forward for us.

Senator LIGHTFOOT—Would that give superannuants more security with respect to their funds? Would it tighten up some of the obvious anomalies that exist where you have negative growth, and serious negative growth, in some superannuation funds? What is the nub of a comprehensive review of that legislation? What is the outcome of it specifically?

Dr Anderson—The outcome for people is, I suppose, a security of knowing how they will be taxed when they eventually retire, not sudden changes. That would be one outcome. The only way you can actually do that is to tax at the end and to decide how you are going to tax at the end. There will be people who will say, 'If we only tax at the end, it is going to be a whim of government that can decide how we'll tax at the end.' But we should be robust enough in our policy to know that if we tax at the end, at the benefit stage, we can in fact address some of the issues about the level of revenue that government should get from retirement savings and about

the level of support that those who are saving should get for their saving activities and we should be able to make that equitable across all people regardless of their income levels.

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Senator LIGHTFOOT—Is your main concern the retrospectivity of the legislation?

Dr Anderson—My main concern is the complexity of the legislation.

Senator LIGHTFOOT—Not the retrospectivity?

Dr Anderson—To me it is retrospective, but one could argue that it is retrospective to put it in line with some other bad legislation.

Senator LIGHTFOOT—Is it good legislation but it is too complex—is that the problem?

Dr Anderson—I think it is bad legislation trying to make it line up with other bad legislation.

Senator LIGHTFOOT—So it has followed on the 1988 legislation?

Dr Anderson—The 1988 legislation has now come home to roost again with us.

Senator LIGHTFOOT—That was the foundation of the subsequent legislation that caused problems in the subsequent legislation? Would that be correct?

Dr Anderson—Yes.

Senator LIGHTFOOT—Let me take a different tack. Would you describe your association as being a peak body for superannuation funds? If not, what would you describe as the peak body?

Dr Anderson—I think we would be the peak body. We have been around for a very long time, representing all types of super.

Senator LIGHTFOOT—You have had competition from other peak bodies, if I could use that expression?

Dr Anderson—We do have other sectoral interests, most of whom we are on good speaking terms with.

Senator LIGHTFOOT—Do you think there is a fragmentation of the industry and that it ought to come under one unambiguous umbrella? I cite, say, the mining industry: although there are chambers of minerals and energy in most states, they come under the Mining Council of Australia. The petroleum industry in Australia has a peak body; there is the Cattlemen's Union; and the farmers have a peak body in most states. They really have little or negligible competition, if any at all. Do you think superannuation funds ought to have one clear, unambiguous stronger voice—I am not saying we should do it with legislation?

Dr Anderson—I think there would be a stronger voice, but I am not sure that we are out of tune with most of the people who are usually members of ASFA and, also, members of some other section or group. I mean most of the people who would appear here would also be members of ASFA.

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Senator LIGHTFOOT—Tell me, what is the difference, say, between your Association of Superannuation Funds of Australia and the Australian Retirement Income Streams Association? What is the fundamental difference between them? I could probably tell you what some differences are—I do not mean the minutiae, but the major differences with respect to those two associations?

CHAIR—Would you like to take that on notice?

Dr Anderson—Yes, I think I would, thank you.

Senator LIGHTFOOT—That has not given me time to think of my next question but—

CHAIR—They might like to take that on notice too! My limit is 20 minutes per witness.

Senator LIGHTFOOT—Okay. It looks like we have run out of time then and I will not put my question on notice either.

[11.52 a.m.]

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GUNNING, Mr Timothy James, Chairman, Superannuation Committee, Financial Planning Association of Australia

CHAIR—Welcome. Would you like to speak to your submission or make an opening statement?

Mr Gunning—I would like to make some comments if I could. In terms of the context of the submission the FPA is probably the peak professional organisation in relation to financial planning in Australia. We have over 11,000 members. We manage the financial affairs of around 3.7 million Australians and have something like \$118 billion under advice. The FPA has a very keen interest in the taxation of superannuation funds, for obvious reasons, and the subsequent effect of these proposed changes on retirement income streams. While it must be said that the FPA welcomes the broadening of the tax base as it relates to perhaps some anomalies which existed in the life insurance industry in relation to the taxation of profits within various businesses, the FPA firmly believes that the proposed changes constitute a new point of taxation in relation to superannuation funds including DIY funds.

Importantly, too, currently there is no basis under the current CGT provisions in relation to the taxation and movement of assets within a trust where there is no beneficial ownership. That is probably the reason for this reliance on this virtual PST, as it has become known. Perhaps more importantly, the taxation on any unrealised capital gains, where a person commences an allocated pension or other superannuation pension, will clearly erode the value of the asset that a person can use to fund income in retirement. Any increased level of taxation upon superannuation savings, I think it would be fair to say, runs contrary to the government's stated objectives in relation to encouraging self-provision in retirement.

The taxation of any unrealised capital gains within the superannuation fund will furthermore seek to destabilise investors' confidence in the superannuation system, which is constantly being tampered with. This is a particularly important issue that the Financial Planning Association has come up against in terms of investment advisers making recommendations in relation to superannuation. Anecdotally, the sort of feedback that we are getting is that investors are losing confidence in superannuation as a result of the constant change. I think this is particularly an issue for self-managed funds that have been subject to a large amount of change recently, and really fundamental changes, in relation to their operation as a result of the introduction of Superannuation Laws Amendment Acts Nos 3 and 4.

The FPA also wants to highlight to the committee that, although the government's proposed delay of the commencement of this bill in terms of 1 July 2005, as it applies to DIY funds, will not benefit other superannuation funds which include obviously other public offer funds and discretionary master trusts. In fact, any superannuation fund that allows for asset transfers between the accumulation phase of superannuation and the pension phase of superannuation will be affected.

The FPA wishes to make a number of points in relation to the deferment of the commencement of the legislation until 1 July 2005. It will not alleviate the administrative

burden placed on the trustees of DIY funds as a result of these proposed changes and, in some instances, may increase the complexity. The FPA also believes that the application of these provisions to DIY funds only is inequitable in relation to their application to other discretionary master trusts and public offer superannuation funds.

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The FPA believes that the introduction of this additional tax to superannuation funds is short-sighted to some extent by reducing the capital that Australians need to fund an income stream in retirement. The FPA believes that this, in turn, will increase social security outlays and at the same time reduce the amount of taxable income generated by these retirement income streams in the future. I guess this will reduce tax revenues in the future.

The FPA believes that this bill should be delayed until a wider inquiry into income streams and superannuation is conducted, otherwise the outcome will be a part solution to a wider issue and it is this type of approach to superannuation that only increases the complexity in relation to superannuation. Most importantly, the point that the FPA wants to make is that this is again eroding the confidence of investors in superannuation, which we are starting to see.

Senator LIGHTFOOT—You said *inter alia* that investors are losing confidence as a result of changes— that was tax changes, I assume, or legislation changes including tax?

Mr Gunning—Legislation changes including tax. This is a particular issue for clients who are investing in DIY funds. If you put this in the context of changes that were contained in terms of the definition of a self-managed superannuation fund and in changes to investments Superannuation Laws Amendment Acts Nos 3 and 4, this is in the wider context of that. This is an additional issue that is eroding the confidence of investors who are investing through these types of structures.

Senator LIGHTFOOT—I understand from evidence we have taken and my own personal observations that investors are also losing confidence because of a nil or negative return or a negligible return on funds that they invest in. Would you agree with that?

Mr Gunning—It is difficult to generalise. I think asset markets have performed reasonably well in the past.

Senator LIGHTFOOT—Put it this way, not all investors are happy with the return they are getting, would you agree with that?

Mr Gunning—Sure. Investors are investing in a number of different types of superannuation funds.

Senator LIGHTFOOT—So that obviously then, *ipso facto*, means that they are also unhappy about the return they are getting.

Mr Gunning—Sure.

Senator LIGHTFOOT—You have \$180 billion under advice. What is the return on your \$180 billion?

Mr Gunning—I could not comment on that. That is a difficult question. Those moneys are invested in a range of different types of asset classes.

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Senator LIGHTFOOT—Can't you average that out and give the committee some idea?

Mr Gunning—No, not today. Perhaps we could have a further look at it.

Senator LIGHTFOOT—Perhaps you could take that on notice and advise the committee.

Mr Gunning—I am happy to do that.

Senator LIGHTFOOT—What would you consider to be an average return for investors on their funds?

Mr Gunning—It is very difficult to comment. That is part of the reason why investors seek the advice of financial planners. It really depends on what assets they are investing in. What the Financial Planning Association seeks to do is to look at investments and investors' risk profile and try to match that against an asset allocation decision that is made by them. It is a very difficult question to ask. It depends on what assets you are investing in.

Senator LIGHTFOOT—You give advice. I imagine your expertise lies in giving advice that enables funds to optimise or even maximise a return?

Mr Gunning—Correct. That decision is based on the risk profile of the client. Different types of investors have different appetites towards risk. Some clients do not like to see volatility in returns and, in fact, negative returns. That may mean that their asset allocation decision was perhaps more conservative than others. Obviously, that is going to effect the return that the investor achieves.

Senator LIGHTFOOT—I asked the previous witness, Dr Anderson, this question about one peak body to cover superannuation funds. Would you agree that fragmentation or division leads to a lack of lobbying effect?

Mr Gunning—Almost certainly it does. The issue in terms of one body to represent all investors is a little difficult. The comment has been made before that there are more superannuation accounts in Australia than there are Australians. It is an issue for each Australian and obviously different interest groups will have different issues they want to raise. The Financial Planning Association is providing broader advice in relation to investments of which superannuation is one tax entity through which investors can make investments.

Senator LIGHTFOOT—My last question is rather complex. Would you tell the committee what your view is of companies accessing so-called salary sacrifice provisions with respect to employees' superannuation?

Mr Gunning—I do not think I understand the question. Are you asking whether we support salary sacrifice?

Senator LIGHTFOOT—Yes, where a company can legally access employee superannuation funds.

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Mr Gunning—In terms of tax deductible contributions made by employers, the Financial Planning Association supports that. That is a large area of advice that financial planners cover in terms of advising clients to make salary sacrifice contributions to super to provide incomes in retirement.

Senator LIGHTFOOT—Is that an anomaly with respect to superannuation? Does that put superannuants' funds in a position of jeopardy?

Mr Gunning—I am not sure I am understanding the question. In relation to where the money ends up—

Senator LIGHTFOOT—Do you think that some companies who use those provisions to legally access employees' superannuation—

Mr Gunning—So are you talking about a situation where employers are using for their own ends the funds that employees have contributed?

Senator LIGHTFOOT—Yes.

Mr Gunning—The current legislative environment we have got is much tighter than it used to be. In most instances that is very difficult to do, and probably for good reasons.

Senator LIGHTFOOT—Are you inferring that perhaps provisions need to be even tighter with respect to that particular provision?

Mr Gunning—I might take that on notice. My view is that the current regime imposes sufficient restrictions on employers to do that.

Senator LIGHTFOOT—You think there are sufficient restrictions?

Mr Gunning—Yes, that is correct.

Senator LIGHTFOOT—But you would like to take it on notice, notwithstanding that answer?

Mr Gunning—That is right.

Senator SHERRY—Going back to the bill, Treasury have told us that the legislation will raise \$70 million minimum. Did you have any discussions with Treasury about the implications of this legislation?

Mr Gunning—We didn't. No, we were not consulted with.

Senator SHERRY—I am led to believe that in fact the amount raised as a consequence of this capital gains tax retrospectivity will be significantly higher than \$70 million. You cannot give us any figures? Can you take it on notice and see if you can get some calculations?

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Mr Gunning—We may be able to look at it, but in terms of the contacts, we are not representing super funds per se.

Senator SHERRY—I understand that.

Mr Gunning—We are representing investors in those funds, so we do not have access to that sort of information.

Senator SHERRY—Do you think that persons—until recently anyway—who were shortly to retire understood the implications of this change on their final retirement income stream?

Mr Gunning—We have found that we have received a lot of inquiry from both financial planners and investors who are obviously reading various reports in the media. I think most of them take a keen interest in their own investments and were reasonably well-informed and we had quite a number of inquiries as to what these changes meant for them.

Senator SHERRY—Have those inquiries come in since the legislation?

Mr Gunning—Since it has been reported in the media.

Senator SHERRY—Which is the same time as the legislation, roughly.

Mr Gunning—Yes.

Senator SHERRY—Did you have any inquiries when the Ralph committee report was released publicly?

Mr Gunning—We had some, yes. I think the issue there was that that was covering a raft of issues. Once this issue came to light in the media as a stand-alone issue, we probably received more inquiries.

Senator SHERRY—Can you refer me to any section of the Ralph committee report that recommended this change?

Mr Gunning—Not specifically, no.

Senator SHERRY—Can you refer me to any commitment given by the government up until 1988 that they would impose a retrospective \$70 million plus capital gains tax change to some superannuants?

Mr Gunning—No, I am not aware of that.

Senator SHERRY—The bottom line is that you do not want this particular provision of the bill passed?

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Mr Gunning—Correct.

Senator SHERRY—So if it is not passed then you want the opportunity to sit down with the government, presumably with most others who have voiced objections to this provision, and take the time to try and iron out the problems you see?

Mr Gunning—The main issue with the financial planning that investors and members of the Financial Planning Association have is that we would like to see a consistent approach to retirement income stream policy and superannuation rather than a piecemeal approach.

Senator SHERRY—I understand that. You were not here when the minister gave his evidence were you?

Mr Gunning—I wasn't.

Senator SHERRY—He did talk about hoping to work out a solution in the context of the complexity issue. But from your point of view as a practitioner, should we not be working out the solutions before the legislation is passed so that you will know when you pick up the legislation what you have got to do?

Mr Gunning—That is always a problem when you have got legislation which is announced before we actually see the legislation itself. That particular issue is a difficult one for investors because at the end of the day we are getting inquiries from trustees of super funds who are obviously investors as well and who are saying, 'Look, what do we do?' It is very difficult to give them advice at this stage.

Senator SHERRY—We are talking here about people who have to make very critical decisions that cannot be reversed, or are very difficult to reverse, about what they are going to do when they are going to retire and what they are going to live on when they retire.

Mr Gunning—I think that is what the FPA is after: some sort of certainty to provide information to clients and investors.

Senator SHERRY—Of any group in the community they are entitled to certainty before they are locked in for the rest of their lives on a strategy or a path in terms of retirement income that may be incorrect?

Mr Gunning—I believe so.

Senator SHERRY—We often get this debate about tax announcements, legislation, retrospectivity, but it does seem to me there is a more important moral issue here for people who are entering retirement and who are entitled to certainty.

Mr Gunning—In terms of investment decisions that are made, one of the most common reasons a person might come to see a financial planner is when they are retiring. It is an important decision and obviously there is often some angst and worry that is attached to that. Certainty in any form would alleviate that and would be welcomed by the FPA.

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CHAIR—Mr Daryl Dixon from Canberra, a financial planner, has been quoted as being full of praise of the benefits of allocated pensions even after the changes and as believing the changes to be equitable. Could you take that on notice?

Mr Gunning—I will.

CHAIR—Thank you.

[12.10 p.m.]

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McDONALD, Mr Peter, National Director, Taxpayers Australia Incorporated; and Chief Executive Officer, Superannuation Australia

SMITH, Ms Barbara, Technical Director, Taxpayers Australia Incorporated; and Technical Director, Superannuation Australia

CHAIR—Our next witnesses are by telephone conference. I apologise for the problem with the plane—it has caused some dislocation to our hearings this morning. Unfortunately, the Senate is sitting at 12.30 and we are not able to continue past that time, otherwise we will be in breach of the standing orders. There will be some background noise at 25 past, when the bells commence to ring. We have quite a large audience in the Senate committee room today, so would you outline for us your major concerns about the legislation?

Mr McDonald—There are eight points we would like to make. One is that the proposed changes have a double taxation effect. There is also a retrospective taxation effect. They will certainly increase the complexity and costs on small superannuation funds due to the valuations that are necessary to be carried out on all assets. There are the tracking and record keeping problems as well. There will also be the need to incur costs on amending deeds. A lot of small deeds will just not have the capacity built into them to enable the segregated elements to apply.

We have some real concerns with the interaction of the now new CGT concessions and also the way superannuation interacts with them. We believe that we now have a situation where superannuation is in fact a non-preferred investment vehicle. The proposed changes also seem to run counter to the policy that was outlined in SLAB 4. We have a major concern that a lot of small businesses in particular that may have transferred their business premises into their superannuation funds may now find themselves at risk.

I have already mentioned the detrimental effect on superannuation as a preferred saving vehicle and we have provided a table in our submission to show you what the effects on superannuation funds are. Another point is that I do not think the changes take into account the flowthrough effect for taxation on pensions and annuities. In effect, the income derived from those sources ends up being taxed in the recipients' hands at their marginal tax rate, so in fact there is no avoidance as such at the end of the day.

The final point that we would like to make is that what we seem to be seeing at the moment is a very ad hoc approach to changes to superannuation which do not take into account the CGT changes and also the small business tax reform changes that have already come in. It would be much better, we believe, to have a total review of superannuation so we can get everything on a level playing field.

CHAIR—Thank you. They are your eight points. Do you wish to amplify any one or two of those that you believe the committee should take cognisance of in particular?

Mr McDonald—I guess there are three. One is the retrospective taxation. The way the changes are going to apply they are literally going to affect all small superannuation funds,

regardless of whether a member is ready to retire or not, so they are locked into their investment strategies and we are going to see a double taxing effect. I already mentioned in my opening remarks that the flowthrough effect is such that the income ends up being taxed in the hands of the recipient at their marginal tax rate. What we are going to have is an additional impost inside the superannuation fund with no flowthrough to the ultimate recipient. In effect, that will raise the marginal tax rate on that income stream to the ultimate beneficiary.

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The other matter that I would like to just briefly touch on is the adverse effect of people now taking up the offer—for want of a better expression—that was contained in SLAB 4 that enables small business operators to effectively put their business premises inside the superannuation fund. If they had actually held onto those assets in their own hands, and we believe there are thousands and thousands and thousands who have actually opted to put the asset in their super fund, the 15-year rule that I mentioned earlier would have applied, or, potentially, the \$500,000 CGT exemption would apply once they achieved retiring age. So, again, we are going to have a massive differential in the taxing effect, depending on what decision you make.

Ms Smith—In fact, the proactive people, the people who have moved quickly, will be the ones who are punished. The likes of lazy accountants who have not talked to their clients are probably going to have clients who are better off now. We also believe that there is a drastic error that will allow tax avoidance. Because of the segregation of each individual asset—there will be five BHP shares in this member's account and five BHP shares in that member's account—and the possibility to move assets in and out of the pool, that allows a big loophole which could be exploited for tax avoidance. Because of the haste with which this is being pushed through, it just has not been well thought through. It has not been discussed by the tax office with the various representatives on superannuation committees where it should have been thrashed out, as were many other things, such as SLAB 4. A lot of the anomalies were actually got rid of because of that. The haste of this going through leaves a massive loophole.

CHAIR—Are you suggesting that perhaps the big life companies may be able to finance their allocated pension through cash flow, whereas the small superannuation funds may have to transfer capital gains type assets and, therefore, be worse off?

Ms Smith—That is one issue, but it is the segregation of the assets that really does concern us. First of all, it requires a lot of complex and costly accounting procedures, and most small funds would not have the mechanism to do that. So that is going to involve them in more external costs. Also, because of the segregation of particular assets, it is going to still allow one member of the fund to segregate assets that they think are going to grow a lot after they have retired and leave the other members of the fund—let us say we have a husband and wife—with assets that are not growing in value.

The approach of segregation is just not appropriate. It should be based on a much simpler method of proportional exemption based on the percentage of the total account for small funds in particular. We have talked to a number of experts on this, as well as amongst ourselves. The most simple approach, and the most equitable, and the one that eliminates tax avoidance, is to have a proportional exemption for pensions once they commence based on the percentage of total assets. That would leave account balances with equal assets. It just avoids this segregation approach, which is not appropriate for small funds with four or fewer members.

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CHAIR—The minister did indicate that the government is prepared to meet with representatives from the industry to look at some of these aspects. So, the door has not necessarily closed completely.

Mr McDonald—We would welcome that, but there is more to this bill, as we mentioned in our opening remarks.

Ms Smith—We just think it is being done too hastily. This ad hoc approach in fact does leave people worse off than if they had left the money outside superannuation, which is not how it should be when we are looking towards an orderly retirement strategy. Superannuation is long-term investment strategy, and it is just totally inappropriate to bring something in on the last days of the financial year which requires all asset valuations to occur on 30 June—that is this Friday—when 50 million other things are happening at 1 July as well.

CHAIR—Based on Senator Kemp's advice, don't advise your clients or readers of your journal to rush off and do valuations or segregate because there may well be changes.

Senator SHERRY—The point is—just following on from the comments by you and Senator Watson—the minister has acknowledged that this is a complex issue and he hopes to work out a solution. The fact is, isn't it, that you want legislation passed that gives you some certainty and you do not want the legislation passed until you have that certainty?

Ms Smith—That is right.

Mr McDonald—Yes, that is absolutely true. At the same time we want to make sure that superannuation is not the forgotten investment child. If I can just put it very simply: the way the changes to CGT that came in from September 1999 work is that we now have a situation where the maximum tax rate for an individual on a capital gain is 24.25 per cent, and there is absolutely no limit on the amount of gain that is subject to that rate. With superannuation funds, you actually are limited to the RBL amount. The actual tax rates are much higher than 24.25 per cent when you factor it all through, and it actually penalises people who are successful investors. I think that is a recipe for disaster from a superannuation perspective. That is basically why we would rather see the entire regime of the tax on superannuation dealt with as a single issue rather than in the piecemeal way that we are doing now.

Senator SHERRY—Treasury told us this morning that the income to be raised from this change is \$70 million a year—that is the first we have heard of it. As I understand it, that is \$70 million—and I am told that it could be higher than that—which is effectively a retrospective change to the application of capital gains tax in this sector, isn't it?

Ms Smith—That is right.

Mr McDonald—That would be, I guess, the immediate and retrospective effect but it does actually have a flow-on effect for ever, so we believe the amount of tax involved would be considerably more than \$70 million.

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Senator SHERRY—Yes, part of the problem is trying to get a grip on the actual figure. You have referred to the flow-on impact and, whilst there is a significant immediate gain to government revenue from the retrospective application of capital gains tax, effectively there will be a loss of revenue at the other end when the person takes the income stream product through lower tax. Do you think it reasonable that Treasury should model something like that to take into account the net cost of this change?

Mr McDonald—Superannuation has tended to be looked at in a vacuum. We have only looked at, say, the taxing effect on contributions. We have not actually looked at the total flow-through effect from the moment the contributions are made until they ultimately flow through to the retiring member through a pension or an annuity. I think that would be a very welcome initiative.

Ms Smith—I think also you cannot underestimate the effect that this has already had on people who are retiring this week rather than continuing to work. We have had hundreds of phone calls. I will just give you one example of a man who is 67, a widower, who has substantial capital gains in his super funds. He was going to continue working in his own business while ever he felt well but he made a decision last week before the Treasurer's announcement to retire and take out his allocated pension. Although Treasury may be recouping some revenue—and superannuation should not just be seen as a revenue recouper—he is actually stopping work well before the time he planned to retire.

A lot of people are of the same mind. They are saying, 'I have capital gains on my super fund and therefore I am going to retire now rather than be subject to all of this additional complexity.' When people are 65 they do not want complexity; they want simplicity. They want to manage their money easily. A lot of people want to manage their own money—an increasing number of people want to manage their own money. They do not want to rot the system; they want a steady flow of income and they want to deal with it simply. They do not want to be paying several thousand dollars accounting fees to keep records which are really producing them nothing.

CHAIR—The committee offers its congratulations to you on the setting up of your new organisation. We look forward to hearing from you on superannuation matters in the near future. We remind you of the references currently before the committee in relation to family law matters, and also the wider reference, which is divided into three parts. Those details are available from the secretariat. We thank you very much and we apologise for the inconvenience you have had this morning in trying to get to the committee. Thank you for the quality of your submission.

Mr McDonald—Thank you.

Ms Smith—Thank you for making this telephone hook-up available. We really appreciate it.

CHAIR—That concludes the committee's proceedings. On behalf of the committee I thank
all witnesses who have given evidence today.

