

# Labor Senators Report

1.1 The Labor members of the Committee support the intention behind the Superannuation Industry (Supervision) Amendment Regulations 2004 (No 2) (“the regulations”), to prevent the use of the SMSF and small APRA fund structure (“small funds”) for tax avoidance, estate planning and other purposes not related to providing retirement incomes. Nevertheless, Labor does not believe that the regulations, 9A and 9B, which together prohibit a fund with less than 50 members providing a defined benefit life time pension, is the appropriate manner with which to deal with the tax, estate planning and other abuses that are possible under the current law.

1.2 The Labor members of the Committee support the first part of these regulations as set out in the Schedule 1, which provide that contributions to accumulation funds must be allocated to a member of a fund and that benefits in an accumulation fund be fully vested in a given member. The relevant regulations deal with the avoidance they seek to regulate in an appropriate and directed manner with no effect on those small funds that do not engage in the targeted abuse.

1.3 Labor does not support those parts of the regulations that prohibit funds of less than 50 members paying defined benefit lifetime income streams.

1.4 The original stated rationale for introducing Divisions 9B and 9A are to prevent:

- tax minimisation through RBL compression; and
- the use of defined benefit pensions for estate planning purposes.

1.5 The way in which tax minimisation and estate planning is effected is set out in the report.

1.6 Labor agrees that the law as it exists provides some opportunity for both tax minimisation and estate planning but it is concerned that neither Treasury nor the Tax Office could produce any figures to indicate the level of occurrence of these activities and the purported loss to revenue.

1.7 Labor is concerned that with the exception of IFSA and Treasury, all other witnesses believed that the regulation 9.2A and 9.2B were poorly drafted and went beyond what was necessary to prevent the abuse they were aimed to prevent. It was also generally agreed that the regulations could be redrafted in a fairer and more targeted manner to achieve the same end.

1.8 Labor takes it seriously that such a significant majority of those individuals and organisations involved in the superannuation industry, though clearly in favour of steps being taken to close the loopholes currently being exploited by a minority in the industry, are opposed to the current form of the regulations.

1.9 An additional reason for prohibiting the payment of defined benefit pensions in small funds, doubts to whether small funds are able to guarantee a lifetime income stream, was raised at the hearing by both IFSA and the Department of Treasury.

1.10 IFSA and Treasury raised the issue of investment risk because they were concerned that a small fund did not have the ability to diversify risk in the manner of a large fund and consequently bad investment decisions would mean that there might be insufficient funds to meet a defined benefit obligation.

1.11 After considering this argument Labor takes the view that the personal nature of small self-managed funds, that is, the fact that the members and trustees are one and the same and control the investments of the fund, makes the situation different from that of the large fund where the trustees manage the fund's investments on behalf of the members.

1.12 In these circumstances, Labor believes that if the members of the small funds are prepared to take this risk, effectively with their own money, they should be permitted to do so.

1.13 Treasury also raised a secondary concern arising from the possible inadequacy of funds to pay a lifetime income stream - a resulting drain on the social security system because of the need to pay the age pension to small fund members whose funds had failed through bad investment.

1.14 Labor takes the view that the number of members of small funds who might find themselves in this position is very small and would have an insignificant impact on revenue. Labor would point out that alternative term income streams may also result in a recipient having insufficient funds at the end of the term and being forced onto a full or part age pension.

1.15 Another argument that has been raised, again by IFSA and Treasury, is that of the level playing field. The view taken by these bodies is that because the members of large funds have to purchase a life-time income stream, ensuring the members of small funds must do so creates a level playing field by putting them in the same position as the members of large funds.

1.16 There are two problems with this argument. First, it will not create a level playing field as there remain many fund members in large defined benefit funds who do not have to purchase an income stream from a financial institution. Secondly, small fund members will find themselves burdened with two sets of fees; the costs of running their small fund plus the costs that will be payable to the financial institution from which they must buy a lifetime income stream.

1.17 According to witnesses at the hearing only four organisations provide a lifetime pension. It is not a very competitive market and it can be anticipated the costs of commercial lifetime income streams will be subject to a raft of fees, charges and commissions.

1.18 Labor is also extremely concerned about the uncertainty for small fund members if regulations 9.2A and 9.2B stand. They are faced with the uncertainty as to what in fact the rules for lifetime pensions will be, not only in the immediate future but also in the long-term.

1.19 Although the existing regime is grandfathered and the date of implementation of the new rules extended until 30 June 2005, the uncertainty that exists about the future is confusing. There is one set of regulations for those already receiving lifetime income streams. Another for those planning to retire before 30 June 2005 provided their fund contains appropriate clauses permitting it to pay a lifetime income stream. The new rules will apply after 30 June 2005 but the planned post election review may recommend alternative regulations.

1.20 This degree of uncertainty for those planning to retire both in the long and short-term is totally unacceptable.

1.21 Labor believes that proposed new regulations 9.2A and 9.2B should be disallowed until such time as the review has been conducted. In the meantime Labor believes the Tax Office has the power under Part IVA to deal with abuses in relation to tax avoidance. Labor also believes the proposed review should be broadened to cover all possible abuses of small funds and to make recommendations regarding reforming the system to make it safe from abuse.

Senator Ursula Stephens

**Deputy Chair**

