The Senate

Economics Legislation Committee

Superannuation Industry (Supervision) Amendment Regulations 2004 (No. 2) [Statutory Rules 2004 No. 84]

August 2004

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ISBN 0 642 71440 1

Printed by the Senate Printing Unit, Parliament House, Canberra.

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CHAPTER 1

INTRODUCTION

Background

1.1 The Superannuation Industry (Supervision) Amendment Regulations 2004 (No. 2), as contained in Statutory Rules 2004 No. 84 and made under the *Superannuation Industry (Supervision) Act 1993*, were notified in the *Commonwealth of Australia Gazette* on 12 May 2004, and tabled in both Houses of Parliament on 13 May 2004.

Purpose of the regulations

1.2 The regulations are claimed to improve the integrity of the superannuation system[1] by addressing an alleged range of tax avoidance strategies primarily involving small and non-arms length superannuation funds (DIY funds). These strategies are allegedly designed to avoid limits applying to tax concessions and social security means tests and allow superannuation to be used for wealth accumulation and estate planning arrangements rather than for retirement income purposes.

1.3 The regulations target potential strategies involving the forfeiture of superannuation benefits and the use of reserve accounts. They also strengthen the prudential standards that apply to funds that provide defined benefits and pensions to ensure that these funds have the capacity to provide the benefits.

1.4 The regulations require:

- benefits in accumulation funds to be fully vested in a given member;
- contributions to accumulation funds to be allocated to a member of a fund;
- defined benefit funds to have at least 50 members; and
- funds providing defined benefit pensions to have at least 50 members.

Reference of the regulations

1.5 On 16 June 2004, the Senate referred the regulations to the Senate Economics Legislation Committee for consideration and report, with particular reference to:

(a) the extent to which defined benefit arrangements have been used for:

(i) the purposes of tax minimization,

(ii) estate planning,

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1 Budget measures 2004-05, Budget Paper No. 2, p.37.

(iii) reasonable benefit limit avoidance, and

(iv) any other purpose other than providing retirement income;

(b) the extent of past losses to revenue from the above measures; and

(c) the estimated future losses to revenue likely in the absence of these regulations.

Submissions

1.6 The Committee advertised its inquiry into the regulations on the internet and in *The Australian* newspaper. In addition, the Committee contacted a number of organisations alerting them to the inquiry and inviting them to make a submission. A list of submissions received appears at **Appendix 1**.

Hearings and evidence

1.7 The Committee held two public hearings in Melbourne on Monday, 26 July 2004, and in Canberra, on Monday, 9 August 2004.

1.8 Witnesses who appeared before the Committee at the hearings are listed in **Appendix 2**.

1.9 Copies of the Hansard transcripts are tabled for the information of the Senate. They are also available through the internet at http://aph.gov.au/hansard.

Acknowledgment

1.10 The Committee wishes to thank all those who assisted with its inquiry.

CHAPTER 2

THE REGULATIONS

Structure of the chapter

2.1 This chapter sets out the evidence received by the Committee. Firstly it identifies the alleged practices targeted by the regulations and examines evidence about the extent of the claimed abuse that the regulations attempt to address. Finally the chapter considers how well the regulations address the problems and the other issues raised during the inquiry.

Practices targeted by the regulations

2.2 The regulations are designed to prevent superannuation fund members using various strategies to avoid tax, inappropriately access social security benefits and facilitate estate planning. They also prevent small funds from providing defined benefits and pensions. The next section outlines the nature of the targeted strategies in turn, and considers how the regulations address such practices. It then turns to the issue of small funds providing defined benefits.

Accumulation funds — preventing the use of forfeiture arrangements

2.3 Forfeiture arrangements[1] may be used by members who, on retirement, have large balances in the superannuation fund and cannot bring the full amount under their reasonable benefit limit (RBL). Provided the governing rules of the superannuation fund include a forfeiture of benefits provision, the member takes only a benefit large enough to remain under the relevant RBL. They forfeit the remaining (excessive[2]) amount of their benefit and it is distributed amongst the other members of the fund for their future superannuation benefits. In a self managed superannuation fund this would usually be a spouse or other associate of the member.[3]

2.4 Items 1 to 3 of Schedule 1 of the regulations are intended to prevent the use of such forfeiture arrangements for tax avoidance purposes by accumulation superannuation funds. Existing regulation 5.08 requires minimum benefits to be identified and maintained in a superannuation fund until they are cashed, rolled over

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1 The description of the various strategies is based on a Parliamentary Library, Client Memorandum, *Background into changes made in 2004 Budget preventing SMSFs from providing complying pensions*, Graeme Selleck, 19 July 2004.

2 An excessive component or amount if taken as a lump sum benefit is taxed at 47 per cent plus the medicare levy. If taken as a pension benefit the amount of the pension that is represented by the excessive amount does not attract the pension rebate.

3 Explanatory Statement, Superannuation Industry (Supervision) Amendment Regulations 2004 (No. 2) 2004 No. 84, p. 2, at: http://scaleplus.law.gov.au/html/ess/0/2004/N/20040512084.htm, viewed on 22 June 2004.

or transferred for a given member's benefit. Also, minimum benefits cannot be used to pay temporary incapacity benefits. Therefore, these benefits cannot be forfeited for the benefit of another member of the fund.

2.5 The regulations aim to prevent forfeiture by amending subregulation 5.04(2) so that all benefits in an accumulation fund become minimum benefits and the restrictions outlined in the previous paragraph will apply to them. Additionally, Schedule 1, item 3 inserts two new subregulations to regulation 5.08 to provide exceptions to the rules regarding the treatment of minimum benefits.

Accumulation funds — preventing contributions from being allocated to reserve accounts

2.6 Reserve accounts are common in superannuation funds. They assist the trustees of accumulation funds in smoothing the risks associated with the fluctuation of investment returns. By maintaining a reserve, trustees have a pool of funds available to provide reasonable crediting rates in years where investment returns are poor or even negative. Defined benefit funds use reserve accounts as a buffer against the fluctuation of investment returns. However, rather than smoothing crediting rates they are used to ensure that the funds have sufficient assets to cover all benefits held by the fund in the event of a decline in the value of the superannuation fund's investments.

2.7 The strategy targeted by the regulations involves the trustees of accumulation funds accepting contributions from an employer and allocating the amount to the reserve account rather than allocating the amount to a member. This strategy has two effects. Firstly, by contributing to a reserve account rather than to an individual member's account, the employer is able to claim a tax deduction for the entire amount of the contribution made to the superannuation fund without being restricted by the aged based deductible contribution limits.[4]

2.8 Secondly, by allocating the contribution to a reserve account the members of the superannuation fund have not received a superannuation contribution from their employer. The result is that the members do not have any surchargeable contributions and there is no superannuation surcharge liability.

2.9 New Division 7.2 in the regulations requires contributions to be allocated to members of accumulation funds. The Division is intended to prevent the practice of allocating contributions directly to reserve accounts or deferring the allocation of a contribution to a member's account to avoid the superannuation surcharge. It is also

4 The aged based deductible contribution limits sets a limit on the tax deduction an employer can claim for contributions they make on behalf of an employee based on the employee's age.

intended to ensure that all accumulation funds have efficient and timely administration procedures in place for dealing with contribution money.[5]

Defined benefit funds and pensions — preventing pension strategies and improving prudential requirements

2.10 As pensions are payments that occur over a future, sometimes very long, timeframe the value of a pension is calculated using actuarial calculations. These calculations make assumptions on future investment returns, indexation of the payments, life expectancy of the member and reversionary beneficiaries (if applicable) and expectations of the underlying assets being sufficient to meet future payments. By manipulating these assumptions, a member can have a pension whose value for RBL purposes[6] is below the pension RBL but supported by, in some cases several million dollars in assets. This reduces the tax the member pays on the superannuation benefit as it will not have an excessive component and it also receives the full rebate available to superannuation pensions under section 27H of the *Income Tax Assessment Act 1936*. It may, subject to the pension being a complying pension and satisfying the income and assets tests for the age pension, allow the member access to the age pension and its associated concessions.

2.11 This strategy can also be used as a method of transferring assets to the member's children (estate planning), provided they are a member of the fund, without being subject to the capital gains tax provisions. When the member dies, depending on the provisions in the superannuation fund's governing rules, the trustees may be able to credit the unused portion of the pension into the accounts of other members of the fund, usually the spouse or children in the fund. This avoids realising assets for capital gains tax purposes as would occur with a distribution from the member's estate.

2.12 There is a separate, more fundamental issue that the regulations seek to address. That is, whether small funds are suitable vehicles to provide a reasonable amount of guaranteed income for an indefinite but guaranteed period. In relation to small superannuation funds, there are three key concerns about the ability of these funds to guarantee such pension entitlements.[7] The first is the lack of an employer sponsor or other intermediary who is obligated to contribute extra money if the fund experiences a period of poor investment returns to the extent that it may jeopardise member entitlements. The second is the lack of risk pooling and the third relates to the management of investment and liquidity risks.

2.13 The lack of risk pooling in these small funds is especially pertinent in relation to mortality risk. A pension for an individual may be paid for a day or far beyond their

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5 Explanatory Statement, Superannuation Industry (Supervision) Amendment Regulations 2004 (No. 2) 2004 No. 84, p.2.

6 Division 14 of Part 3 of the *Income Tax Assessment Act 1936* includes the formula and provisions for determining the value of a pension for RBL purposes.

7 *Transcript of Evidence* (proof copy), 26 July 2004, Thomas, p.51.

life expectancy. Consequently there may be too much money in the fund or not enough. In larger funds with pooled arrangements, there is greater certainty that deaths will occur in a more predictable manner which enables a closer estimation of future benefit liabilities. Additionally, the unused entitlements of shorter-lived members can be used to ensure the benefits of longer-lived members.

2.14 To date, small funds have been able to offer defined benefit pensions (lifetime and life expectancy pensions) in the absence of risk pooling by determining the rate of the pension based on an actuarial calculation to ensure the underlying funds are at least sufficient to meet the income stream offered. An actuary is required to annually certify to this effect. In the event that the funds become insufficient, the pension must be recalculated.

2.15 One way that small funds address the risks involved is to maintain high investment reserves, which may remain after the death of the member. While this can ensure that the fund has a buffer against periods of lower returns, it raises the issue of whether it is appropriate for the concessional superannuation environment to be used to build up funds that will not directly be used to provide income in retirement.

2.16 Additionally, unlike in large defined benefit schemes where outstanding funds remain in the pool to balance risk, reserves in small superannuation funds are used for the benefit of other members who are in many cases related to the deceased member. In effect, members of self managed superannuation funds are able to enjoy the benefits of a pension from the fund while they are alive and to pass the remaining assets to their family after their death. This option is not available in other funds. Therefore, it is claimed that from a competitive neutrality standpoint the regulations provide for a more level playing field between funds.

2.17 Item 10 inserts new Divisions 9.2A and 9.2B into Part 9 of the Principal Regulations, which contain prudential requirements for the Financial Management of Funds. Division 9.2A will require that all new defined benefit funds, or defined benefit funds that admit new defined benefit members, are to be of a sufficient size to pool member benefits to satisfactorily manage mortality and investment risks. The division will also prevent small defined benefit funds from being established, or from accepting new members.

2.18 A new defined benefit fund must now have at least 50 defined benefit members. Likewise, an existing defined benefit fund can only admit a new defined benefit member, or convert an existing member to a defined benefit member, if it will have at least 50 defined benefit members after accepting or converting the defined benefit member.

2.19 Similarly, Division 9.2B is intended to restrict the provision of defined benefit pensions to funds that supposedly are of sufficient size to satisfactorily manage the investment and mortality risks of providing those pensions. It provides that a regulated superannuation fund that has less than 50 members must not provide a defined benefit pension. The Division will apply to new superannuation funds established after the

commencement of the regulations, where the governing rules of the fund provide for the payment of a defined benefit pension, and to existing superannuation funds, where the governing rules are amended after the commencement of the division to provide for the payment of a defined benefit pension. It will not apply to certain specified public sector superannuation schemes.

2.20 These so-called '50 member rules' effectively prevent small funds such as Self Managed Superannuation Funds (SMSFs),[8] small APRA funds and small corporate funds from offering defined benefit pensions to their members.

2.21 If the governing rules of an existing superannuation fund set out the terms and conditions of the defined benefit pension prior to the commencement of the regulations, the new division will not apply. However, if the governing rules are amended to specify a term or condition of the pension, prior to the commencement of that pension, then the new division will apply.

Transitional arrangements

2.22 The Committee notes that on 25 June 2004, the effect of the regulations was modified by the Superannuation Industry (Supervision) Amendment Regulations 2004 (No. 8), Statutory Rules 2004 No. 155. These new regulations do not alter the substance of Statutory Rules No. 84, but they provide a transitional period to ensure that small superannuation funds are able to continue to provide defined benefit pensions to those who were members on 11 May 2004 and who retire or attain age 65 before 1 July 2005, if the first pension payment is made within 12 months after the day when the person became entitled to the pension.

2.23 Additionally, the Government will conduct a review, headed by the Treasury, and in consultation with the Australian Government Actuary, the Australian Taxation Office, industry and other stakeholders, into the safety and tax avoidance risks of defined benefit pensions. The review will examine the continued demand for complying defined benefit pensions and whether such a product can feasibly be provided by a small fund in a manner that is not detrimental to the integrity of the retirement income and tax system. It will be finalised by April 2005.[9]

2.24 Submissions were generally dissatisfied with the regulations, with only two submitters supporting the changes. Of those who were opposed, several recommended that the regulations be disallowed and the remainder sought either amendments to the regulations, or changes to the underlying superannuation industry supervisory regime which would enable the regulations to be withdrawn.

2.25 Submissions and evidence to the inquiry raised two issues. First, the extent to which the problems are in fact widespread or serious, and their impact on taxation

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8 SMSFs are also referred to in the Report as DIY funds (do-it-yourself funds).

9 The terms of reference for the review were released on 5 August 2004, and can be found at: http://assistant.treasurer.gov.au/mtb/content/pressreleases/2004/001.asp.

revenue. Second, the extent to which the regulations as drafted address those problems appropriately. The Committee will consider these issues in more detail below.

Extent of abuse in the superannuation system

2.26 Submissions from industry groups were unable to quantify the extent to which the above strategies are being used and most reported that they had no knowledge of such strategies.[10] They suggested that, if they are occurring, they are by no means widespread throughout the small funds industry.[11]

2.27 The Institute of Actuaries of Australia pointed out that what may appear at the DIY fund level to be abuse of the system is, in reality, an attempt to comply with conflicting elements of different pieces of legislation.[12] Mr deLancey Worthington, Managing Director of Actuarial Solutions, illustrated the point with the following example in relation to defined benefit pensions:

> There is the SIS legislation, which is worried about the security of members' benefits, and, as far as the SIS legislation is concerned, the more reserves the better. Then there is the tax legislation. It is worried about the fair allocation of tax concessions and the collection of tax revenue. It requires the actuary to calculate the liability on a best-estimate basis. You can think of that as being roughly a 50 per cent probability level. It is the amount that on average is required to meet the pension payments. However, the SIS legislation, which is worried about the security of members' benefits, says there has to be a minimum of a 70 per cent probability that the assets will be sufficient. So the difference between the 70 per cent level and the 50 per cent level results in reserves, and the tax legislation says those reserves are taxable at 15 per cent on their investment earnings. This situation does not arise for allocated pensions and growth pensions. It arises only for defined benefit pensions.[13]

2.28 A number of witnesses attempted to provide the Committee with estimates about potential abuses in the system by examining their pension portfolios.[14] They concluded that only relatively few pensions (between 2 per cent and 5 per cent) with a pension purchase price in excess of $1 million, appear potentially to be being used for the purposes of such tax avoidance or estate planning. While acknowledging that

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10 Submission 4, CPA Australia, p.1; Submission 6, PricewaterhouseCoopers, p.1; Submission 9, Investment and Financial Services Association Ltd (IFSA), p.2; *and* Submission 10, Small Independent Superannuation Funds Association Ltd (SISFA), p.1.

11 *For example*: *Transcript of Evidence* (proof copy), 26 July 2004, Watson, p.44; *and* Submission 8, Institute of Actuaries of Australia, p.3.

12 Submission 8, Institute of Actuaries of Australia, p.3.

13 *Transcript of Evidence* (proof copy), 26 July 2004, Worthington, p.28.

14 *Transcript of Evidence* (proof copy), 26 July 2004, Watson, p.44; *and* Submission 2, Actuarial Solutions Pty Ltd, p.1.

opportunities for abuse do exist, the Committee was told that very few people take advantage of this.[15]

2.29 Further, Mr Worthington argued that lifetime pensions provide higher taxation revenue than do allocated pensions and growth pensions.[16] In part this is attributable to their longer term than other pension types and also to the fact that their larger reserves are capable of generating greater earnings growth as they accumulate over time.

2.30 However, by contrast, officers from the Treasury and Australian Taxation Office told the Committee that the arrangements targeted by the regulations were increasingly the subject of promotion in the superannuation and financial planning industry.[17] They said that, in the last few years, the benefits that could be obtained were regularly included in the conference programs of lawyers, financial planners and accountants. For example, the following quotations are taken from papers presented to the Committee by the Treasury. In relation to defined benefit pensions:

> … the annual value of the life time or life expectancy pension can be made to be a moveable feast, depending on the design of the pension.[18]

And in relation to vesting entitlements and benefit assignments:

> The use of superannuation funds which provide non-vested entitlements, enabling reallocation of wealth between family members on an intergenerational basis, is a well established concept at the small end of the market. It operates not just as a method of reducing exposure to penal RBL excess benefits tax. It also has the capacity to deliver enduring benefits to families as wealth creation vehicles which are subject to concessional rates of tax for lengthy periods.[19]

Additionally:

> Finding yourself with an RBL problems [sic] at the end of the accumulation phase of a well performing Self-Managed Fund is careless, because there are planning tools available to permit a fund member to limit the extent to which they find themselves with benefits which are in excess of the reasonable benefit limits.

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15 *Transcript of Evidence* (proof copy), 26 July 2004, Watson, p.44.

16 Submission 2, Actuarial Solutions Pty Ltd, p.13; *and Transcript of Evidence* (proof copy), 26 July 2004, Worthington, p.30.

17 *Transcript of Evidence* (proof copy), 26 July 2004, Thomas, p.51.

18 Andrew Fairley, Partner, IFS Fairley, Melbourne, *Superannuation as a Member Wealth Creation Device: Part I – Accumulation Phase*, Superannuation 2002 A National Conference for Lawyers, Session Five, p.7.8.

19 Andrew Fairley, Partner, IFS Fairley, Melbourne, *Superannuation as a Member Wealth Creation Device: Part I – Accumulation Phase*, Superannuation 2002 A National Conference for Lawyers, Session Five, p.7.15.

> Strategies include the reserving, or setting aside, of investment returns earned by the fund, and the non-vesting of certain kinds of superannuation benefit standing to the credit of the accumulation account of the member of the fund.[20]

2.31 Treasury's aim is to 'nip in the bud' any growth in this area:

> Clearly the arrangement was likely to become much more popular with higher wealth individuals. … The government has acted early to stop the spread of an arrangement that was promoted to provide benefits beyond that which the ordinary person could consider reasonable.[21]

2.32 As regards the impact that the arrangements would have on taxation revenue, Mr Trevor Thomas, General Manager, Superannuation, Retirement and Savings Division, Department of the Treasury, told the Committee that the Government has acted before the proliferation of the arrangements would have given rise to significant revenue costs. This is due to the fact that most small superannuation funds are currently in the accumulation stage rather than the benefit payment phase where the cost to revenue could be expected to be considerable if the arrangements were allowed to continue. The Government was concerned that the promotion of the strategies, in conjunction with the increase in the number of retirees and with larger account balances, would over time create a significant risk to revenue.[22]

2.33 As the Australian Taxation Office data does not currently allow separate identification of the amount of tax collected from excess benefits, no quantification of the cost to revenue is available. Additionally, in relation to the loss of revenue resulting from the practice of RBL compression, ATO data would only reflect the post arrangement circumstances and in the absence of account balance information, the ATO has no way of establishing how much taxation revenue is foregone as a consequence.

2.34 The Department of the Treasury provided the Committee with comparative scenarios between allocated, market linked and lifetime pensions. The data clearly showed that the income taken from a lifetime pension can be considerably less than the minimum required to be taken under each of the allocated and market linked products.[23] Because of the low pension payment, over time this results in a significant build-up in the fund in nominal terms which is not apparent with the other two pensions. Additionally, the lower income taken can allow the recipient access to the age pension and its attendant concessions.

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20 Gary Riordan, Partner, Holding Redlich Lawyers, *Self-Managed Superannuation Funds Strategies to Prosper: An Update*, FPA Convention, Melbourne, 1 May 2004, p.14.

21 *Transcript of Evidence* (proof copy), 26 July 2004, Thomas, p.52.

22 *Transcript of Evidence* (proof copy), 26 July 2004, Thomas, p.52.

23 Department of the Treasury, paper presented to the Committee illustrating the characteristics of different pension products.

2.35 In each case, the balance remaining in a small fund at death is available for payment to dependants tax free or to the estate. How the estate distributes the death benefits will determine the tax outcomes. The larger the amount remaining in the fund at older ages, the greater the likelihood that a significant amount will remain on death. If beneficiaries are also members of the fund, there is the possibility that monies will be transferred to their accounts and remain in the accumulation phase attracting concessional tax treatment for a further 30 years or more.

2.36 According to the Australian Government Actuary, about 75-80 per cent of the initial investment for small funds paying defined lifetime pensions is expected in real terms to be applied to retirement income.[24] That is, the expected residual value for these products is about 3 to 5 times that for the other products. Almost 25 per cent of the initial investment is expected to remain in the fund on death.

Committee comment

2.37 The Department of the Treasury and the Australian Taxation Office were asked to provide both an estimate of the number of individuals who were exploiting the defined benefit pension rules to achieve estate planning ends and the cost to revenue of this activity. While the agencies gave a general warning of the problem, they were unable to provide any figures in response to this request.

2.38 The Committee notes the difficulties inherent in producing quantitative data in relation to alleged abuses of the system.

Consultation

2.39 Several witnesses were concerned at the lack of government consultation with the industry prior to the announcement on budget night of the changes in the regulations. Mr McDougall, Chief Executive Officer, SISFA, stated that contrary to past practice, when industry consultation had been very good, the measures were announced in the budget without any prior discussion.[25] Mr Tony Coles, Manager, Superannuation, Retirement and Savings Division, Department of the Treasury told the Committee that:

> It has long been government practice that you do not consult on integrity measures. There is a perceived integrity concern in relation to these arrangements, and so you address the law clearly and decisively.[26]

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24 Australian Government Actuary, paper presented to the Committee, *Small Superannuation Funds – Actuarial issues: Consequences for Taxation and Social Security Arrangements*.

25 *Transcript of Evidence* (proof copy), 26 July 2004, McDougall, p.3.

26 *Transcript of Evidence* (proof copy), 9 August 2004, Coles, p.12.

Extent to which the regulations address the issues

2.40 The Investment and Financial Services Association Ltd (IFSA) told the Committee that it is the close relationship between members and trustees of certain small superannuation funds that may enable the targeted strategies to be used.[27] As these can only work where dealings within the fund are not at arm's length, to the extent that such behaviour is occurring, the amendments will particularly impact on self managed superannuation funds.

2.41 The industry submissions were supportive of measures to address the use of contrived arrangements to avoid tax, but they argued that the regulations are not appropriately targeted to achieve their stated aim. They suggested that some of the regulations will target large as well as small funds, and additionally, in many places they are poorly drafted and ambiguous.[28]

2.42 Many believe that a blanket ban on defined benefits provided from small funds is inappropriate. For example, Mr Davison, Superannuation Policy Adviser, CPA Australia, said:

> … to address the system would have made more sense than to disrupt the retirement plans of many people approaching retirement who had quite often funded for many years towards using a particular structure in their self-managed fund to move into retirement. To be fair, the new growth pensions and market-linked income streams will provide people access to the pension RBL and to social security, so those options are available in the future. But we believe there is clearly a need for defined benefit type pensions within your self-managed funds—one, the more term-certain type products and, two, products for those who are after a smoother type of income stream throughout the life of their retirement. If we actually address the system instead of putting on a blanket ban, we should be able to continue to operate those sorts of structures without detrimentally affecting the system as a whole.[29]

2.43 The Committee was told that those who wish to abuse the system will continue to find ways to do so despite the regulations.[30] Furthermore, the regulations will have an adverse impact on many bona fide arrangements, such as:

- some funds will incur higher compliance and other costs;
- members will have less flexibility in taking their retirement benefits; and

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27 Submission 9, Investment and Financial Services Association Ltd (IFSA), pp.1 and 2.

28 Submission 1, Institute of Chartered Accountants in Australia, p.1; *and* Submission 8, Institute of Actuaries of Australia, Attachment, Letter to the Minister for Revenue & Assistance Treasurer, pp.1, 7 and 11.

29 *Transcript of Evidence* (proof copy), 26 July 2004, Davison, p.37.

30 Submission 8, Institute of Actuaries of Australia, p.3.

- some employers are likely to reduce their support for superannuation which will result in lower retirement benefits for employees.

2.44 The Institute of Actuaries of Australia suggested that the regulations do not address the root causes of the problem, but they impose limitations on some types of funds, whilst allowing others to be restructured or redesigned.[31]

2.45 The Committee will consider these arguments and other issues raised in relation to each of the practices that the regulations seek to address below.

Forfeiture arrangements

2.46 As regards the regulations that prevent people from forfeiting their benefits, witnesses and submissions were concerned that other legitimate arrangements would be affected. In particular, witnesses commented on the potential impact of the regulations on employee retention schemes.

Vesting scales

2.47 Superannuation is said to vest in a member when the member becomes legally entitled to it.[32] Some employer sponsored superannuation funds have progressive vesting scales to encourage employees to stay with the organisation. In such a fund a member is entitled only to a proportion of the employer's contributions (other than mandatory contributions) in the early years of employment, and entitled to all employer contributions only after a set period (eg five or ten years).

2.48 Witnesses thought that the requirement that contributions are vested in a member will retrospectively affect legitimate arrangements that were agreed with a member on joining a fund several years beforehand.[33] Although regulation 5.08 sets out exemptions to the rules regarding the treatment of minimum benefits, witnesses were concerned that these were unclear.[34] Mr Ward, Institute of Actuaries of Australia stated that:

> … in regard to vesting, the regulations use very strange words. The new regulations say that 'minimum benefits are all of the member's benefits'. I really do not know what that means. Is it all the benefits that can be provided if the member were to resign today or is it his death benefit? I do not know.[35]

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31 Submission 8, Institute of Actuaries of Australia, p.4.

32 ASFA dictionary of superannuation online, at: http://www.asfa.asn.au/dictionary/dict_main.htm.

33 *Transcript of Evidence* (proof copy), 26 July 2004, Ward, p.11.

34 Submission 1, Institute of Chartered Accountants in Australia, p.4.

35 *Transcript of Evidence* (proof copy), 26 July 2004, Ward, p.10.

2.49 He also suggested that there would be few cases where the exemptions contained in the regulations would apply:[36]

> The exemption applies when there is a written agreement between the employer and the employee that sets out particular vesting rules. In our experience it is extraordinarily rare for that to occur. The vesting rules are normally set out in the fund's governing rules, set out in the member booklet and in the product disclosure statement. If anything, there is an agreement between the member and the trustee; the employer is not really involved in that agreement.

2.50 However, the IFSA states that it is clear that on-market, arm's length arrangements are not the target of these measures, and the regulations and explanatory note make a clear distinction between SMSF practices and legitimate vesting and reserving practices in arm's length superannuation funds.[37] It notes that APRA's modification powers under section 328 of the Superannuation Industry (Supervision) Act can provide relief where arrangements meet the spirit but not the letter of regulation 5.08(2).

Response from the Treasury

2.51 Mr Tony Coles, Manager, Superannuation, Retirement and Savings Division, Department of the Treasury told the Committee that there is a great diversity in the market and it appears that the exemptions set out in the regulations have not captured all the circumstances where there might be bona fide employment vesting arrangements in place.[38] However, the regulator has the power to issue modification orders on an individual or a class basis to deal with these arrangements. APRA is considering issuing a modification declaration to address the circumstances where vesting arrangements are set out in one or more constituent documents other than those specified in the regulations.

Allocating contributions to reserve accounts

2.52 The regulations require that contributions are allocated to members of accumulation funds. Two issues were raised in evidence: it will create difficulties where employers have been meeting fund expenses; and it will not prevent surcharge avoidance as there is no specification that contributions must be allocated to the member for whom the employer is claiming a deduction. These issues are considered further.

2.53 According to the Institute of Actuaries of Australia (IAA), many employers have been willing to meet some or all of the expenses of running a superannuation fund for employees, rather than have these expenses withdrawn from member

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36 *Transcript of Evidence* (proof copy), 26 July 2004, Ward, p.11.

37 Submission 9, Investment and Financial Services Association Ltd (IFSA), p.2.

38 *Transcript of Evidence* (proof copy), 9 August 2004, Coles, p.12.

accounts.[39] In its experience larger funds already have been notionally allocating such contributions amongst members for surcharge reporting purposes. It considers that if other funds are not following this practice, then the problem lies with the ATO audit process and/or a lack of clear explanation of these requirements to trustees.

2.54 The IAA says that the regulations will create considerable initial and ongoing administrative costs for many funds as they change their practices to comply. Further costs will be incurred to amend trust deeds and Product Disclosure Statements and provide explanations to members. The Institute states that some employers will be required to breach agreements with employees specifying that expenses will not be deducted from member accounts.

2.55 Accordingly, the effect of the regulations will be that if employers are prepared to continue meeting expenses (including the cost increases from the regulations), then members will see higher contributions going into their accounts with higher expenses coming out. At best, the member will be no better off. However, if employers are no longer prepared to meet expenses in this way and hence reduce their overall level of contributions, members will receive lower benefits.

2.56 The IAA suggests that the regulations should be amended so that any contribution that is used to pay an expense or insurance premium within 12 months does not need to be allocated to members.

2.57 As regards Division 7.2 of the regulations which requires contributions to be allocated to members, the CPA Australia was concerned that there will continue to be scope for avoiding the superannuation surcharge because the provisions do not specify that contributions are to be allocated to the person they are meant for:

> An example in the regulations where there is still a problem with what is being suggested is to do with surcharge avoidance—having contributions allocated within 28 days of the contributions going into the fund and having them vest 100 per cent in the person concerned. The problem with that is that it does not actually say that the contributions have to be allocated to the person they are meant for. I can still allocate them to the spouse or whoever it is I want to allocate them to and avoid the surcharge in that way. All it has done is change when I am allocating it. It is not changing who I am allocating it to and it is not keeping those contributions in the members' hands that they were actually being made for. The easy or better solution to that would have been to change some of the tax rules to deny the deductibility if the contributions are not given to the right person. So even just in terms of that simple change, what is in the regulations is not enough to get us over the hurdle of solving the surcharge issue.[40]

39 Submission 8, Institute of Actuaries of Australia, p.7.

40 *Transcript of Evidence* (proof copy), 26 July 2004, Kelleher, p.38.

Response from the Treasury and the Australian Taxation Office

2.58 Officers from the Treasury and the Australian Taxation Office (ATO) told the Committee that the person to whom the contribution is allocated is the person for whom a tax deduction must be claimed.[41] Mr Mathew Hanscombe, Director, Government Initiatives, said that the ATO has already made it clear in public statements that contributions that are not allocated to members within their employees' age base limits are not deductible. There are clear statements to this effect on the record.[42]

Small defined benefit funds and pensions

2.59 Generally witnesses and submissions were most concerned about the impact that the regulations would have in preventing small superannuation funds from offering defined benefit pensions.

2.60 The Committee understands that the regulations are primarily targeted at very wealthy people who are using defined benefit pensions from small funds. For example, Mr Bill Stanhope, Senior Policy Manager, Investment and Financial Services Association Ltd (IFSA), said that it is an issue for Australians who have more than the pension RBL, and are by definition, already millionaires in superannuation.[43] Mr Bloore told the Committee that it is larger asset holders who use defined benefit pensions more than people who retire with $300,000 to $400,000 in their superannuation fund.[44]

2.61 However, not all witnesses held this viewpoint. For example Mr Watson, Director PricewaterhouseCoopers told the Committee that 93 per cent of people with a defined benefit pension that the company certifies, have assets of less than $500,000:[45]

> We believe that the overwhelming majority of mums and dads legitimately use their DIY funds to provide an income stream in retirement, and in some cases, an income for their spouse and/or children on their death.[46]

2.62 A distinction between small corporate funds and self managed funds is that any reserves in an SMSF are not available to a widespread membership, and in a single member fund, they pass either to the individual or to their estate.[47] The SMSF fund member / trustee is still able to retain effective control of the assets in reserves.

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41 *Transcript of Evidence* (proof copy), 26 July 2004, Lejins, Hanscombe, p.60; *and* Lejins, p.65.

42 *Transcript of Evidence* (proof copy), 9 August 2004, Hanscombe, p.11.

43 *Transcript of Evidence* (proof copy), 26 July 2004, Stanhope, p.24.

44 *Transcript of Evidence* (proof copy), 26 July 2004, Bloore, p.42.

45 *Transcript of Evidence* (proof copy), 26 July 2004, Watson, p.44.

46 Submission 6, PricewaterhouseCoopers, p.1.

47 *Transcript of Evidence* (proof copy), 26 July 2004, Stanhope, p.18.

2.63 Mr Worthington suggested that the reserves required to pay a defined benefit pension on average comprise about 20 per cent of the assets of the fund.[48] He told the Committee that the tax on the investment earnings of the assets contributes to the tax system whereas an allocated or growth pension is fully tax exempt. It is only the income tax on the actual pension payment that makes any contribution to the tax system. In this way, Mr Worthington argued, allocated and growth pensions are a drain on the tax system, but defined benefit pensions with a purchase price of less than $1 million contribute to the economy through taxation.

2.64 According to Mr Graeme McDougall, Chief Executive Officer, Small Independent Superannuation Funds Ltd (SISFA), the regulations will significantly reduce the number of income stream options available to small superannuation funds in terms of their ability to provide retirement streams themselves without purchasing a retail product outside of the fund.[49] He told the Committee that the market linked pension that will be available from 20 September 2004 is no replacement for the fixed term or life expectancy pensions that were previously available to all superannuation funds.

2.65 To force people to go outside of their small superannuation fund to purchase a retail product will be anathema for some:

> A number of clients have expressed the concern that their superannuation pensions (apart from allocated pensions) will now be forced to be provided by institutions only. Generally, our clients have established their DIY funds with the view that they have a say in the assets that they purchase, when and how they are purchased and how those assets are used to provide income streams, for them in their retirement, assets to support their spouse in their demise and the residual amount to pass to their children. These changes take away the very things that give people the comfort to use superannuation as an entity. DIY funds are established by clients predominantly because they wish to be involved in the provision of their own future, by selecting the assets they wish to have and how and when it is paid to them and their estates.[50]

2.66 Witnesses were concerned that members of small funds would be forced to liquidate fund assets to purchase a defined benefit retail product. This would incur capital gains tax as well as fees and charges to be paid to the income stream provider.[51] These costs would be in addition to the self-managed fund's own operational costs and would reduce the income available to the retiree.

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48 *Transcript of Evidence* (proof copy), 26 July 2004, Worthington, p.27.

49 *Transcript of Evidence* (proof copy), 26 July 2004, McDougall, p.2.

50 Submission 7, Smartsuper Pty Ltd.

51 *Transcript of Evidence* (proof copy), 26 July 2004, Lorimer, p.5; Ward, p.14; Kelleher, p.36; *and* Watson, p.47.

2.67 In addition to the increased costs, there may be difficulties for the fund trustees in purchasing a retail product that matches the benefit design of the superannuation fund. According to Mr Heffron, Institute of Chartered Accountants in Australia, there are only about four providers of these types of product in Australia:

> So there is not much competition in the marketplace in any case at the moment, which is one of the reasons—there are several other reasons—why they look relatively expensive compared to taking your DB lifetime pension from your own fund.[52]

2.68 In some cases the small superannuation fund's assets may be in the form of a business real property investment which other members of the fund are operating.[53]

> A lot of these self-managed funds are structured around a block type of asset, like a property that a business is using, and it is generating a good income. It is generating an income a lot higher than they could get if they went out and bought some fixed interest securities. But they will be forced to sell that asset, because it is so blocky, when someone retires and it will have consequences not only for the person who is retiring but also for the remaining members. They are losing that asset and are not able to use it within the fund, and also there will be the capital gains tax on the asset at the time it is sold.[54]

2.69 There is also the issue that people do not wish to relinquish leftover funds to a retail provider if they die early:

> Talking to people about taking lifetime, life expectancy pensions, they are not concerned about additional tax costs if they have tax to pay within their small funds and things of that nature. If they die and there is money left in the fund, they are happy if that money gets allocated to other members in the fund. They are happy that there is surcharge on that and they are happy that that is creating RBL issues for the other people within the fund. They just do not want to see their pool of money potentially being lost within the life companies. Nobody that they know is going to benefit. If anyone is going to benefit, it is the life companies at the end of the day.[55]

2.70 However, Mr Stanhope, Senior Policy Manager, Investment and Financial Services Association (IFSA) argued that the regulations create a level playing field so that, with the introduction of the complying growth pension (term allocated pension) retirees can access largely the same assets from an allocated pension fund or from a self-managed superannuation fund:[56]

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52 *Transcript of Evidence* (proof copy), 26 July 2004, Heffron, p.35.

53 *Transcript of Evidence* (proof copy), 26 July 2004, McDougall, p.6.

54 *Transcript of Evidence* (proof copy), 26 July 2004, Worthington, p.29.

55 *Transcript of Evidence* (proof copy), 26 July 2004, Kelleher, p.36.

56 *Transcript of Evidence* (proof copy), 26 July 2004, Stanhope, p.19.

> The real need that retirees seem to have to control their assets in a self-managed fund, to get access to growth assets, can be met just as much inside a self-managed fund as it can in an on-market fund through a combination of allocated pension and term allocated pension to build up the right kind of tax, social security and annual income profile that retirees want.[57]

2.71 The IFSA considers that the recognition of market linked income streams will provide a solution for many retirees whose total superannuation assets lie somewhere between the social security assets test threshold and the pension RBL.[58] This solution could be effected through an SMSF, a Small APRA Fund or a retail fund. Consequently, the IFSA does not believe this group will be unduly affected by the regulations preventing small funds from offering a defined benefit income stream.

2.72 The IFSA and the Association of Superannuation Funds (ASFA) both support the change, although the ASFA commented in its submission that outcomes similar to those expected by introducing the regulations may have been achievable through other, less disruptive measures.[59]

Response from the Treasury

2.73 Mr Tony Coles, Manager, Superannuation, Retirement and Savings Division said:

> One of the major criticisms of these measures was that we were forcing people into the arms of the life companies. One of the issues was that these funds should be able to provide their own pension within the fund. We are allowing the small funds to continue to provide their own pension within the fund. So there will not be, supposedly, the impact of excessive fees or charges imposed by the life companies; they are just not there, because it is provided within the fund.[60]

Committee response

2.74 The Committee notes that small superannuation funds are still able to provide complying allocated pensions, and from 20 September 2004, a complying market linked pension. Therefore they are not left with no pension option. However, if retirees desire the security of a lifetime pension, their only option under these regulations is to purchase one from a retail provider.

2.75 Additionally, the Committee notes the evidence from the IFSA that term allocated pensions, complying fixed term income streams and allocated pensions all

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57 *Transcript of Evidence* (proof copy), 26 July 2004, Stanhope, pp.18-19.

58 Submission 9, Investment and Financial Services Association Ltd (IFSA), p.3.

59 Submission 3, Association of Superannuation funds of Australia Limited (ASFA).

60 *Transcript of Evidence* (proof copy), 9 August 2004, Coles, p.5.

pass a remaining superannuation balance to an estate on early death. Both allocated pensions and term allocated pensions can be offered through an SMSF or a Small APRA Fund.[61]

2.76 In what follows the Committee discusses the major issues raised in evidence concerning the provision of defined benefits by small funds:

- risk pooling;
- the transitional arrangements;
- small corporate funds;
- social security assets test;
- reasonable benefit limits; and
- estate planning.

Risk pooling

2.77 The IFSA claimed that the underlying rationale for the 50 member rule in the regulations is sound:

> … defined benefit arrangements are based on the principle of pooled risk, and below a minimum pool size there would be no real risk pooling.[62]

2.78 However, other witnesses rejected this argument about risk pooling. They suggested that a defined benefit fund can operate effectively irrespective of the number of members.[63] The Committee was told that all funds are subject to investment risk and this can generally be controlled by an appropriate investment strategy. The Small Independent Superannuation Funds Association Ltd (SISFA) disputed the idea that funds with fewer than 50 members would not be financially viable in terms of their ability to pay defined benefit pensions.[64]

2.79 Several witnesses used examples of funds comprising differing proportions of defined benefit and accumulation style members to support their argument that the number of 50 members is an arbitrary amount and does not necessarily make a lot of sense.[65] For example, Mr Lorimer, Director and Chair, Small Independent Superannuation Funds Association Ltd (SISFA) told the Committee:

> As far as defined benefit pensions are concerned, the requirement under the regulations is simply for any fund that pays a defined benefit pension to

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61 Submission 9, Investment and Financial Services Association Ltd (IFSA), p.4.

62 Submission 9, Investment and Financial Services Association Ltd (IFSA), p.2.

63 *See for example*: Submission 8, Institute of Actuaries of Australia, p.5; *and* Submission 10, Small Independent Superannuation Funds Association Ltd (SISFA), p.3.

64 *Transcript of Evidence* (proof copy), 26 July 2004, Lorimer, p.4.

65 For example, *Transcript of Evidence* (proof copy), 26 July 2004, Ward, p.11.

> have 50 members—not 50 defined benefit pension members but rather 50 members. … conceivably you can have the situation of a fund with 50 members, only one of whom is in receipt of a defined benefit pension and the other 49 are accumulation style members. It seems absurd to us that that size of fund is in a better position to pay a defined benefit pension than a single-member fund. It is ridiculous.[66]

2.80 Furthermore witnesses were concerned that the regulations are unclear and poorly drafted. For example, Mr Ward, Institute of Actuaries of Australia, said that:

> One of the first things that struck me when I read the new regulations was: what on earth do these regulations mean? They use terms that I—a person who has been involved in the industry for 30 years—found very confusing and difficult to interpret. There are already two different definitions of a defined benefit fund in the regulations, depending on what purpose we are dealing with. There are effectively different definitions for a defined benefit member. And now we have a new set of regulations which imposes in effect a limit of 50 defined benefit members for any fund that wants to provide defined benefits, be they lump sums or pensions. We now have another regulation which imposes a 50-member limit—not 50 defined benefit members but 50 members—which restricts funds with less than 50 members from providing defined benefit pensions. So I am totally confused. I do not know whether a defined benefit pensioner is actually a defined benefit member under the definitions in these regulations. I am even concerned that an accumulation style member who has insurance cover is actually classified as a defined benefit member.[67]

2.81 Some witnesses also took issue with the idea that the non arm's length relationship between trustees and members in a self-managed fund was a factor in these funds' ability to provide legitimate retirement income streams:

> In our view, there are enough regulatory and prudential requirements embodied in the income tax and superannuation laws to ensure that any superannuation fund, large or small, notwithstanding any relationship between trustees and members, is able to pay these sort of benefits.[68]

2.82 However, Mr Ward from the Institute of Actuaries in Australia told the Committee that the defined benefit income stream from a self-managed fund is very different in nature to that paid from a life office, a corporate fund or a public sector fund:

> I think this is one of the difficulties with the payment of lifetime pensions from single member funds. Where you have a corporate fund or a public sector fund with a defined benefit pension, then you effectively have a guarantor. Where you have a payment from a life office, you have a

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66 *Transcript of Evidence* (proof copy), 26 July 2004, Lorimer, p.4.

67 *Transcript of Evidence* (proof copy), 26 July 2004, Ward, p.10.

68 *Transcript of Evidence* (proof copy), 26 July 2004, Lorimer, p.6.

> guarantor who is effectively covering the risk. In a self-managed fund you do not have a guarantor and therefore you have the choice of maintaining reserves to protect against the event of poor investment experience or living longer than your life expectancy. But that inherently involves some deferral of receipt of income, but you have to set the income stream lower in the first place in order to do that. I would say that the defined benefit income stream from a self-managed fund is a different beast to that paid from a life office or a corporate fund or a public sector fund. It could be that it is better to look at the nature of the beast and redefine the beast in a manner which is more acceptable and avoids some of these difficulties that we have in trying to make a square peg fit in a round hole by getting actuaries to try to chip around the edges of it.[69]

2.83 The Committee notes the research provided by the Department of the Treasury that showed that a defined benefit pension has lower income streams, pays lower tax, has access to greater age pension payments and also provides a residual significantly higher than other accumulated and growth pensions.[70]

Response from the Treasury

2.84 Officers from the Treasury told the Committee that 50 members is a number that already exists in the Superannuation Industry (Supervision) legislation.[71] It is in the arm's-length equal member representation rules. While the number is used in a different context, Mr Trevor Thomas, General Manager, Superannuation, Retirement and Savings Division, said:

> In a different context, certainly, but there is less confusion if it is linked to something that is already known to people in SIS. Fifty provided a reasonable pooling system, which, as Mr Martin has said, gives some degree of comfort. Obviously we could have gone for a higher number—200 or something like that—which is also mentioned in SIS, but that is substantially higher and the government was not convinced that it was justified to go to that level.[72]

2.85 Additionally, Ms Erica Lejins, Senior Adviser, Superannuation Retirement and Savings Division, clarified for the Committee that if a fund is paying a defined benefit, it must have 50 defined benefit members.[73] However, if the fund is paying a defined benefit pension, it may have 49 accumulation members and 1 defined benefit pensioner member:

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69 *Transcript of Evidence* (proof copy), 26 July 2004, Ward, p.16.

70 Department of the Treasury, paper presented to the Committee illustrating the characteristics of different pension products.

71 *Transcript of Evidence* (proof copy), 9 August 2004, Coles, p.26.

72 *Transcript of Evidence* (proof copy), 9 August 2004, Thomas, p.26.

73 *Transcript of Evidence* (proof copy), 9 August 2004, Lejins, p.26.

> Importantly, the 50-member threshold for a fund paying a defined benefit pension may provide for somewhat less pooling. However, it does provide a practical implementation mechanism. Importantly, it does ensure that the trustees and members of the fund are at arm's length and that these arrangements are genuine.

2.86 Mr Peter Martin, Australian Government Actuary, explained how the additional risk pooling from 50 members can provide greater stability for a fund:

> A fund paying a pension to a male aged 70 will ask itself what its cash requirements are going to be in 10 years time …. The answer is that it will be paying either zero pensions in 10 years time or one. There is a good chance that it will be paying one, but there is a good chance that it will be paying zero. It cannot predict confidently what level of pensions will be payable in 10 years time—it is going to be nought or one. But if a fund with 50 members is asked the same question it can predict confidently that in 10 years time it will be paying between 30 and 40. So it can get a good feel for its cash flow.[74]

Transitional arrangements

2.87 The Committee received evidence about the transitional arrangements in the Superannuation Industry (Supervision) Amendment Regulations 2004 (No. 8) 2004 [Statutory Rules, 2004, No. 155] that modify the effect of the regulations of the Committee's inquiry. These regulations ensure that retiring members of small superannuation funds are able to continue with their plans to commence a defined benefit pension through their fund between 11 May 2004 and 1 July 2005.[75]

2.88 The SISFA told the Committee that these regulations do not provide a transitional period, but rather are an ineffective attempt to grandfather existing arrangements under the main regulations.[76] This is because a draft superannuation determination (SD 2004/D1) issued to clarify when an SMSF can provide a defined benefit pension, takes a very narrow interpretation of what constitutes a fund's governing rules. Mr Lorimer told the Committee that as a consequence, there will virtually be no fund in the marketplace that would be in a position to satisfy the grandfathering arrangement:

> It is such a ridiculously narrow interpretation and one, it is probably fair to say, which would not accord with what the industry's mainstream view is of what constitutes a fund's governing rules. So it is an ineffective grandfathering provision. The transitional period is similarly a very limited one. It only applies to people who are in existing funds, and there is only a

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74 *Transcript of Evidence* (proof copy), 9 August 2004, Martin, p.25.

75 Explanatory Statement, Superannuation Industry (Supervision) Amendment Regulations 2004 (No. 8) 2004 No. 155, p.1.

76 *Transcript of Evidence* (proof copy), 26 July 2004, Lorimer, p.8.

> very short time for them to make up their minds whether they want to retire and those sorts of things.[77]

2.89 Mr Watson, Director, PricewaterhouseCoopers, told the Committee that for most retirees the trust deeds reflect the requirements of the existing law, which is framed in terms of the pension being indexed between certain amounts and sets out the general terms and conditions.[78] It is not until the person actually gets to retirement that they decide the level of pension and the exact terms, and it is set at that point. There would be very few trust deeds that meet the conditions in the Determination, other than defined benefit corporate funds where the employee entitlements have to be prescribed in the trust deed specifically so that when the employee commences employment they know exactly what the terms and arrangements are when they cease with the employer.

2.90 The Institute of Chartered Accountants in Australia noted that the transitional regulations will not assist people who have planned for their retirement by using an SMSF that they have not yet established:

> They know that they are going to get a certain benefit from their corporate fund or their master trust down the track, and their intention was to set up a DIY fund in order to run their retirement, but now they are not being given the opportunity to do so and take a DB pension, which may have been the plan that was in place all along.[79]

Response from the Treasury and the Australian Taxation Office

2.91 Mr Trevor Thomas, General Manager, Superannuation, Retirement and Savings Division, Department of the Treasury, told the Committee that under the transitional regulations that are in place, those people who are retiring before 1 July 2005 are in essentially the same position as they were before the budget announcement and the making of the regulations [Statutory Rules 2004 No. 84].[80]

2.92 The transitional arrangements are intended to assist those people who had a clear intention to retire within their small fund.[81] The Government considered that there were constraints in drawing a line in the sand to assist those who may not have finalised their plans to enter into the transitional arrangement to the extent that it becomes a mechanism to avoid the intention of the law.

2.93 Additionally, the transitional arrangements ease the requirement in the regulations that there are specific pension details in place for the period of the

77 *Transcript of Evidence* (proof copy), 26 July 2004, Lorimer, p.8.

78 *Transcript of Evidence* (proof copy), 26 July 2004, Watson, p.47.

79 *Transcript of Evidence* (proof copy), 26 July 2004, Heffron, p.37.

80 *Transcript of Evidence* (proof copy), 9 August 2004, Thomas, p.4.

81 *Transcript of Evidence* (proof copy), 9 August 2004, Coles, p.9.

transition.[82] During this period, trust deeds can be changed in a manner sufficient to set up a defined benefit pension through an SMSF.

Small corporate funds

2.94 The Institute of Actuaries in Australia (IAA) was most concerned about the effect that the restrictions will have on small corporate funds. It suggests that longevity risks which may be associated with small pools of pensions, are only relevant to a very few corporate funds. The vast majority of these have benefit designs whereby mortality risks can be controlled by an appropriate level of insurance.[83]

2.95 Furthermore, the IAA asserts that small defined benefit funds are usually associated in the corporate sector with multinational employers who sponsor defined benefit funds around the world, and with executive schemes of (generally large) Australian companies. This means that the overall risk profile for members is reduced because these funds are small in relation to the size of the employer.

2.96 The IAA was also concerned that the regulations will impose additional costs for employers in providing different types of benefits, and possible industrial relations issues as the same classes of employees will become entitled to different benefits.[84] Ultimately it considers that there is a danger that employers will decide to provide the minimum in benefits and will not go beyond their strict legislative obligations. The IAA asserts that this is not consistent with encouraging saving for retirement.

2.97 Additionally, Mr Ward told the Committee that the regulations created difficulties for corporate funds that were intending to close and transfer to a master trust before 30 June 2004.[85] For many employers who wanted to provide the same benefits to their employees in another structure, that was no longer possible as the master trust arrangement was considered to be a new fund and the transfer could not happen unless an exemption from the Australian Prudential and Regulatory Authority (APRA) was obtained:

> In a number of cases, those exemptions were obtained, but it took so long that the transfer was delayed, and went past 30 June, which meant that the fund has incurred considerable additional costs, another APRA levy, more audit fees and more administration fees. This has had a significant adverse impact on some of those funds. It has also created some problems for some employers who have got a small fund. They are currently providing defined benefits for their employees. They may no longer be able to provide the same benefits for a new employee who joins. That means they have to set up a different structure of superannuation for their new employees. Again,

82 *Transcript of Evidence* (proof copy), 9 August 2004, Nicholson and Hanscombe, p.9.

83 Submission 8, Institute of Actuaries of Australia, p.5.

84 Submission 8, Institute of Actuaries of Australia, p.5.

85 *Transcript of Evidence* (proof copy), 26 July 2004, Ward, pp.10-11.

> it might be possible to get an exemption from APRA. I am certainly aware of at least one case where that exemption has not been forthcoming.[86]

2.98 Mr Stanhope from the IFSA considers that in the above circumstances APRA should use its modification declaration powers under section 328 of the Superannuation Industry (Supervision) Act to ensure that the regulations do not have unintended consequences.[87] He told the Committee that initial discussions with APRA in relation to this have been positive.

2.99 However, Mr McDougall, SISFA, considers that small corporate funds were targeted by the regulations rather than becoming inadvertently caught up by them:

> I cannot help but think that one of the triggers for it to come up with this wonderful figure of less than 50 was as another tool which APRA were using to get rid of these small corporate funds that they have been trying so hard to get rid of for so long. That is another issue which is not in our area, but we know that that is an actual case.[88]

Response from the Treasury

2.100 The Committee notes the evidence from Ms Erica Lejins, Senior Adviser, Superannuation, Retirement and Savings Division, that both the Australian Prudential Regulation Authority and the Australian Taxation Office may exempt funds from the 50-member rule in circumstances where there are adequate arrangements in place to fund future pension benefits and the trustee and members of the fund are at arm's length.[89]

Social security asset test

2.101 Complying defined benefit pensions are currently exempt from the social security asset test which has allowed wealthy individuals, in some cases, to access Centrelink entitlements. However, PricewaterhouseCoopers points out that the asset test and income rules for social security are effectively the same for DIY funds and for life office annuities and so the regulations will not prevent the mischief from occurring:

> Thus the same outcomes can be achieved either through a DIY fund or by purchasing a life office annuity, so banning life-time and fixed term income streams from DIY funds simply moves the problem from one area to another. Banning these income streams from DIY funds delivers life offices a competitive advantage in this regard.[90]

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86 *Transcript of Evidence* (proof copy), 26 July 2004, Ward, p.11.

87 *Transcript of Evidence* (proof copy), 26 July 2004, Stanhope, p.19.

88 *Transcript of Evidence* (proof copy), 26 July 2004, McDougall, p.9.

89 *Transcript of Evidence* (proof copy), 9 August 2004, Lejins, p.25.

90 Submission 6, PricewaterhouseCoopers, p.3.

2.102 The Department of the Treasury and the Australian Taxation Office were asked to provide an estimate of the additional cost to revenue and additional call on social security that could arise when a small fund paying a defined benefit pension was unable to meet part or all of its obligations and the retiree is forced to resort to social security. Because the bulk of self managed superannuation funds is currently in the accumulation phase and not paying pensions, the agencies found it difficult to provide data.

2.103 Several submissions[91] consider that recent changes made to the superannuation regime more generally will of themselves significantly reduce the level of abuse in relation to defined benefit pensions. These changes tackle the specific issues rather than the more broad-brush approach of the regulations. They are:

- the reduction in the social security asset test exemption from 100 per cent to 50 per cent for new pensions. This will significantly limit the ability of those with large superannuation benefits from accessing the old age pension; and
- the introduction of market linked growth pensions which will enable retirees to take a complying pension that is not a defined benefit pension.

Reasonable benefit limits

2.104 Witnesses considered that, to the extent that there is a problem, it does not lie with avoidance of the Reasonable Benefit Limits (RBLs), but with the formula used by the Australian Taxation Office (ATO) for calculating the value of a pension for RBL purposes.[92] They told the Committee that the pension valuation factors used by the ATO considerably understate the true value of the pension, giving rise to an RBL value which is often lower than the actual purchase price of the pension.

> In this regard, the current actuarial requirements under SIS regulation 9.31 arguably permit the commencement of a defined benefit pension at an inappropriately low level relative to the capital supporting it. This has the potential for an 'artificially' low RBL value and/or unreasonably high benefit reserve to be achieved. This is as a result of the regulation requiring the actuary to express an opinion that a fund has a 'high degree of probability' (i.e. 70% probability) of being able to pay the defined benefit pension. The requirement is a minimum one, meaning that a higher degree of probability could possibly be applied, with a lower level of pension as a consequence.

91 *Transcript of Evidence* (proof copy), 26 July 2004, Davison, p.34; Submission 6, PricewaterhouseCoopers, p.3; *and* Submission 8, Institute of Actuaries of Australia, p.4;

92 Submission 2, Actuarial Solutions, pp.9-12, Submission 6, PricewaterhouseCoopers, p.2, Submission 7, Smartsuper Pty Ltd, Submission 8, Institute of Actuaries of Australia, p.4; Submission 10, Small Independent Superannuation Funds Association Ltd (SISFA), p.2; *and* *Transcript of Evidence* (proof copy), 26 July 2004, Worthington pp.27-28; Davison, p.34; *and* Watson, p.45.

> The potential to manipulate this position could be addressed by amending regulation 9.31 to require defined benefit pensions to be commenced with no greater than a high degree [70%] of probability.[93]

2.105 Consequently, according to witnesses, it is both unreasonable and unfair to apply a blanket ban to DIY funds when it is the government's own formula which is at fault and the regulations will not solve the issue. In addition these regulations will not change how defined benefit pensions are valued for RBL purposes:

> In fact, under the new Regulations, if a retiree is willing to purchase a life office annuity through their DIY fund, and use the proceeds to provide a life-time pension from the fund, they would still achieve the same low RBL valuation … since the new Regulations do nothing to change how a life-time pension is assessed for RBL purposes.[94]

2.106 The pension valuation factors used to calculate the capital value of a pension are, according to CPA Australia, 10 years out of date and appear to be out of line with life expectancies.[95] Mr deLancey Worthington, Managing Director, Actuarial Solutions, commented that if the pension valuation factors were recalculated using the latest life tables and a rate of return of approximately nine per cent, then on average, they would increase by 37 per cent. The higher factors would result in higher and more representative values being assigned when calculating the capital value of a superannuation pension for RBL purposes.[96]

2.107 Another solution proposed by witnesses was that a pension be assessed on a purchase price basis:

> That is the methodology that is used for growth pensions, allocated pensions and defined benefit term pensions. It is also the method that is used for life office annuities. So it would bring consistency across the board. It would also remove the ability for people to compress their RBL. It would also remove the ability to add undeducted contributions to remove an RBL problem.[97]

2.108 Accordingly, if this occurred, the 95 per cent or so people who are within their RBL would not be affected. In fact, according to Mr Worthington, they would gain an advantage from the change:

> At the moment, because the amount of pension that they purchase results in an RBL value of only 57c in the dollar, to satisfy the so-called 50-50 rule to

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93 Submission 10, Small Independent Superannuation Funds Association Ltd (SISFA), p.4.

94 Submission 6, PricewaterhouseCoopers, p.2. *See also* Submission 7, Smartsuper Pty Ltd, *and* Submission 10, Small Independent Superannuation Funds Association Ltd (SISFA), p.2.

95 Submission 4, CPA Australia, p.2.

96 *Transcript of Evidence* (proof copy), 26 July 2004, Worthington, pp.27-28.

97 *Transcript of Evidence* (proof copy), 26 July 2004, Worthington, p.28; *and also* Submission 10, Small Independent Superannuation Funds Association Ltd (SISFA), p.2.

> meet their pension RBL they may have to commit two-thirds of their retirement money to purchasing a lifetime pension and then only one-third goes into the allocated pension. It is not a 50-50 split of assets; it is a 50-50 split by RBL value. If we changed it to purchase price, those people could do a 50-50 split by the amount of money that they are retiring with and they could actually have more money in the allocated pension where they have access to the capital. They would be happier.[98]

Estate planning

2.109 Any residual left from an annuity after the death of the recipient is generally kept by the retail provider. Any residual remaining after death from a DIY defined benefit pension remains within the fund and can be distributed to the beneficiaries. The regulations target the incentive for DIY funds to use the concessional superannuation taxation structure to maximise a recipient's estate after death, rather than for genuine retirement income.

2.110 However, Mr Cohen from PricewaterhouseCoopers told the Committee that the fact that the DIY fund retains any assets left over after the death of a member does not represent an abuse of the system – it is just one of the attractions of using such a fund to pay a pension in retirement.[99] Other witnesses similarly argued that this feature offers a 'fair go' for Australians who do not see the value of purchasing a lifetime life office annuity when the life office keeps the remaining assets.[100]

2.111 Some witnesses suggested that this feature of DIY funds does not constitute tax avoidance because if the residual is bequeathed to another member of the same fund, the money stays in the fund in an accumulation phase under another person's name and cannot be used until the beneficiary moves into the pension phase. If the residual is bequeathed to a beneficiary outside of the fund, it will be taxed accordingly.[101] By contrast, Mr Stanhope suggested that remaining assets in a DIY fund will pass 'pretty much tax-free' to other people.[102]

2.112 Some witnesses provided the Committee with solutions to overcome perceived estate planning strategies. For example, the Institute of Chartered Accountants in Australia thought that estate planning advantages available to small funds could be overcome by the specification of actuarial valuation criteria as occurs for funds wishing to meet the requirements for the receipt of a means tested pension or the retention of term certain pensions:[103]

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98 *Transcript of Evidence* (proof copy), 26 July 2004, Worthington, p.28.

99 Submission 6, PricewaterhouseCoopers, p.3.

100 Submission 2, Actuarial Solutions Pty Ltd, p.5. *See also Transcript of Evidence* (proof copy), 26 July 2004, Bloore, p.43.

101 *Transcript of Evidence* (proof copy), 26 July 2004, McDougall, p.3; Worthington, p.32.

102 *Transcript of Evidence* (proof copy), 26 July 2004, Stanhope, p.25.

103 Submission 1, The Institute of Chartered Accountants in Australia, p.1.

> This would give the member the option of a fixed or CPI indexed income stream aimed at utilising capital over the member's lifetime. This would need to be implemented in consultation with The Institute of Actuaries Australia to ensure that the limitations offered by the probability test can be overcome.

2.113 Mr deLancey Worthington noted that there is a requirement in the social security legislation that the amount of pension should repay the purchase price over the term of the pension. He recommended that this should be included in the superannuation industry (supervision) legislation. If that occurred, there would be a minimum level of pension that must be provided in a defined benefit pension arrangement so there would no longer be cases of people with substantial assets, taking very small pensions.[104]

Response from the Treasury

2.114 The Department of the Treasury believes that defined benefit pensions provide a disproportionate benefit compared with alternative products:

> A fixed term pension provides a great opportunity for providing residual capital value. That means that the assets have been used to provide an income. Also, the concessional tax treatment associated with payment of the pension—in that about 80 per cent of them put it aside tax free, because they are supporting the pension, and that is going to be dependent upon how the actuary values those assets—provides an opportunity for wealth accumulation and intergenerational fund transfer so that benefits are not being fully utilised to pay the pension of the retiree. The assets can be there and can be used to provide benefits and intergenerational wealth transfer to children and so forth.[105]

2.115 Mr Thomas, General Manager, Superannuation, Retirement and Savings Division, told the Committee that proposals to amend the RBL formula are unlikely to resolve the issue of inappropriate estate planning, nor would they solve the fundamental concerns about the sustainability of small funds providing a guaranteed benefit.[106] The pension valuation factors, while somewhat dated, are also used to value lifetime pensions provided by large public sector and corporate funds. The issue would need to be carefully considered before any amendment could be made as a change to the factors could have a significant impact on a much wider range of people than the membership of smaller funds.

2.116 Mr Coles, Manager, Retirement and Savings Division, further explained:

> In this matter you have to consider what the formula is. It is the annual value times the pension valuation factor minus the undeducted

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104 *Transcript of Evidence* (proof copy), 26 July 2004, Worthington, p.28.

105 *Transcript of Evidence* (proof copy), 26 July 2004, Coles, p.57.

106 *Transcript of Evidence* (proof copy), 26 July 2004, Thomas, p.54.

> contributions plus any residual capital value. The annual value is subject to some concerns that it can be manipulated, perhaps, to produce a low annual value for the formula so that the amount of assets providing that pension is in excess. That is multiplied by the pension valuation factors which in SIS are based on life expectancy. Important in this is the amount of undeducted contributions. As was presented to me the other day, the wealthier you are the less of a reasonable benefit limit problem you have. The more money you can put into your fund as an undeducted contribution the lower you can bring the assets, the capital value of the product, below the RBL.
>
> I guess in considering each of these elements—and I have excluded the residual capital value because for complying pensions it cannot have one; it must be zero—we need to identify that it can be subject to manipulation at the front end. Pension valuation factors are somewhat dated but there are broader ramifications to fix that for the rest of the community.
>
> **Senator SHERRY**—Why couldn't you just fix it or change it for the SMSF funds? Why couldn't you just apply a specific formula for these funds? Do you have a legal problem with that?
>
> **Mr Coles**—Conceptually, we looked at the abuse in relation to these funds. These funds are also conceptually unstable in providing a guaranteed pension. In weighing that up, and to address the arrangement early, the government decided to amend the law to fix the abuse—the fact that non arms-length arrangements were being used inappropriately.[107]

2.117 Additionally, because of the interconnectedness between taxation, social security and superannuation systems certain changes may have downstream effects:

> If you start playing around with the formula, then there is going to be a ripple effect throughout the whole treatment of the RBL system. For example, if you just play with pension valuation factors, you are actually going to be playing around with the income streams that public servants receive, the income streams provided by large corporates, such as old BHP funds—the benefits that they are going to receive in their retirement. If you try and fiddle around with the residual capital values then that also has impacts on other parts of the tax act.[108]

Conclusion

2.118 Although many witnesses to the inquiry disputed that there is abuse of the superannuation system needing to be addressed by the regulations, the Committee notes Treasury's advice that this is an emerging phenomenon it intends to 'nip in the bud'.

2.119 The Committee notes the potential of non-arm's length funds to be used to build large residual balances that can be steadily increased in the concessional

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107 *Transcript of Evidence* (proof copy), 9 August 2004, Coles, p.21.

108 *Transcript of Evidence*, 9 August 2004, Coles, p.29.

superannuation environment and passed to beneficiaries, rather than being used for retirement income purposes.

2.120 However, in the absence of detailed statistics as to the extent of abuse, the Committee accepts that the extent of the abuse and potential abuse is a matter for some conjecture.

2.121 A number of witnesses expressed concern that the regulations are not well targeted and that they will have unintended consequences. On the other hand, the Treasury considers that the issues raised can be adequately addressed by the grandfathering provisions, the granting of exemptions, and the use of the modification power under section 328 of the Superannuation Industry (Supervision) Act.

2.122 The Committee has some sympathy with the views of some witnesses that the regulations are a 'sledgehammer' rather than a 'scalpel' approach to removing any potential for abuse.

2.123 However, the Committee is concerned that if the regulations are disallowed or withdrawn now, a window of opportunity would be created for the establishment of many more defined benefit funds, and for existing funds caught by the regulations to tighten their governing rules and trust deeds, with the intention of exploiting loopholes in the legislation.

2.124 Hence, the Committee believes that the regulations should not be disallowed but equally believes that they should apply only temporarily, until the Government's announced Review is finalised and further advice considered. The Committee recommends that, following the consideration, new regulations which allow self managed superannuation funds adequate flexibility to provide a range of pensions but which also more acutely target any potential abuse replace these regulations.

Senator George Brandis
Chairman

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 30June 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 30June 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

AUSTRALIAN DEMOCRATS SUPPLEMENTARY REPORT

1.1 The Australian Democrats are concerned that the integrity of the superannuation system is being abused by the promoters of aggressive tax planning involving the use of small self-managed superannuation funds. This Senate Inquiry did not quantify the extent of the abuse, but did confirm to us that it is occurring.

1.2 We are generally supportive of any measures to close loopholes and will be supporting of Regulation 5.04(2), 5.08 and Divisions 7.1 and 7.2 applying specifically to forfeiture arrangements and allocation of contributions to reserves within accumulation funds.

1.3 The application of Divisions 9.2A and 9.2B in the Regulations, applying to the provision of defined benefit pensions, have been more controversial.

1.4 The Democrats acknowledge that it is more appropriate for lifetime pensions to be paid from larger superannuation funds that are better equipped to deal with the inherent mortality, investment and liquidity risks. Having said that, we do not believe that lifetime pensions should be necessarily be purchased from the large life offices.

1.5 In our opinion, the integrity of the taxation system should be addressed. Strategies such as 'RBL compression', even if they are not widely being used at present, should be 'nipped in the bud', to use the Treasury expression. The announced Treasury review of the defined benefit pensions, due to be finalised by April 2005 should include a broader review of the taxation treatment of superannuation pensions.

1.6 We believe that allocated pensions and market linked pension are more appropriate for a small self managed fund partly because they do not involve the annual actuarial compliance costs associated with lifetime pensions. The changes that will apply from 20 September 2004 will increase the options available to members of self managed superannuation funds.

1.7 We are also concerned by the heavy selling of self-managed Super by certain elements of the financial sector often to people whose balances are so low that that the high management fees are not justified. There is a clear need to educate investors with smaller superannution balances about the high costs and risks involved with self-managed funds.

Conclusion

1.8 In our opinion, the Government's intention to improve the integrity of the superannuation system by addressing a range of tax avoidance strategies is admirable. However, we are concerned that simply removing the ability of small self-managed

funds to pay lifetime pensions unfairly reduces the options available to legitimate members of self-managed funds.

1.9 Our preference is to correct the perceived tax avoidance opportunities that has driven the marketing of lifetime pensions from self managed super funds. Disallowance of the Regulations, along with the uncertainty of an upcoming Federal election could allow this tax avoidance and abuse to continue for another year. A preferable approach might be to seek to amend the regulations to address the concerns we have outlined.

1.10 We will continue to work with whichever political party is in Government with a view reducing the opportunities for tax avoidance, whilst providing flexibility within the payments of pensions from self-managed superannuation funds.

1.11 We reserve the option to support appropriate legislation which could target tax avoidance retrospectively from 13 May 2004.

Senator John Cherry

Appendix 1

SUBMISSIONS RECEIVED

Submission Number	Submittor
1	The Institute of Chartered Accountants in Australia
2	Actuarial Solutions Pty Ltd
2a	Actuarial Solutions Pty Ltd
3	Association of Superannuation Funds of Australia
4	CPA Australia
5	Pro-Super Australia Pty Ltd
6	PricewaterhouseCoopers
7	Smartsuper Pty Limited
8	Institute of Actuaries of Australia
9	Investment & Financial Services Association Ltd
10	Small Independent Superannuation Funds Association Ltd (SISFA)
11	Cumpston Sarjeant Truslove Pty Ltd
12	Heffron Consulting Pty Ltd
13	Portfolio Planning Solutions
14	Mr Ben Korman

Appendix 2
PUBLIC HEARINGS AND WITNESSES

MONDAY, 26 JULY 2004 - MELBOURNE

BLOORE, Mr Andrew, Managing Director
Smartsuper Pty Ltd

BURT, Mr Michael Donald, Actuary
Australian Government Actuary

COLES, Mr Tony, Manager, Superannuation, Retirement and Savings Division
Department of the Treasury

DAVIES, Mr William, Marketing
Smartsuper Pty Ltd

DAVISON, Mr Michael, Superannuation Policy Adviser
CPA Australia

HANSCOMBE, Mr Mathew, Director, Government Initiatives
Australian Taxation Office

HEFFRON, Mr Martin John, Member, Superannuation Committee
Institute of Chartered Accountants

KELLEHER, Ms Noelle, Member, Financial Advisory Services Centre of Excellence
CPA Australia

LEJINS, Ms Erica Noble, Senior Adviser, Superannuation, Retirement and Savings
Division Department of the Treasury

LORIMER, Mr Michael Dale, Director and Chair
Small Independent Superannuation Funds Association Ltd

MARTIN, Mr Peter, Australian Government Actuary
Australian Government Actuary

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

NICHOLSON, Ms Tracey, Assistant Commissioner, Superannuation
Australian Taxation Office

ORCHARD, Mrs Susan Janet, Superannuation Technical Adviser
Institute of Chartered Accountants

SHALLUE, Mr Paul, Convenor, Legislation Subcommittee
Institute of Actuaries of Australia

STANHOPE, Mr Bill, Senior Policy Manager
Investment and Financial Services Association

THOMAS, Mr Trevor John, General Manager
Superannuation, Retirement and Savings Division
Department of the Treasury

WARD, Mr John, Member, Legislation Subcommittee
Institute of Actuaries of Australia

WATSON, Mr Cohen John, Director, Retirement Incomes and Asset Consulting
PricewaterhouseCoopers

WORTHINGTON, Mr deLancey, Managing Director, Senior Actuary
Actuarial Solutions Pty Ltd

MONDAY, 9 AUGUST 2004 - CANBERRA

BURT, Mr Michael Donald, Actuary
Australian Government Actuary

COLES, Mr Tony, Manager, Superannuation, Retirement and Savings Division
Department of the Treasury

DOLAN, Mr Alex, Assistant Secretary, Seniors and Means Test Branch
Department of Family and Community Services

HANSCOMBE, Mr Mathew, Director, Government Initiatives
Australian Taxation Office

LEJINS, Ms Erica Noble, Senior Adviser
Superannuation, Retirement and Savings Division, Department of the Treasury

MARTIN, Mr Peter Colin, Australian Government Actuary
Australian Government Actuary

NICHOLSON, Ms Tracey, Assistant Commissioner, Superannuation
Australian Taxation Office

THOMAS, Mr Trevor John, General Manager
Superannuation, Retirement and Savings Division, Department of the Treasury