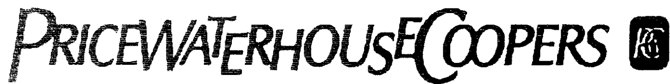

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Superannuation Industry (Supervision) Amendment Regulations 2004 (No. 2)

Cameos provided by Treasury/ Govt. Actuary

I refer to the recent inquiry held into Superannuation Industry (Supervision) Amendment Regulations 2004 (No. 2), and the "cameos" provided by Treasury and the Australian Government Actuary to the Committee, which were not available to the general public until after the hearings had finished. I have since seen these on the "aph" website.

I am concerned that there are several glaring omissions in the way the cameos have been constructed by the Govt. Actuary and/or Treasury which would have a material impact on the analysis and comparison of the life-time pensions presented versus the other pensions. I have taken these issues up directly with the office of the Australian Government Actuary and am awaiting a response. In particular:

- The analysis of the life-time pension does not appear to take into account the tax that would be payable each year on the income on the taxable reserve component of the account balance (ie the portion above the best estimate value of the pension). This would result in a significantly higher tax take on the life-time pension than shown in the analysis presented.

- The cameos state that the balance remaining in the fund on death is tax free to dependants. While this is the case for allocated and market-linked pensions, this is not correct for complying life-time pensions. Life-time pensions do not have a residual capital value by definition (under the legislation), and therefore, any balance remaining on death is

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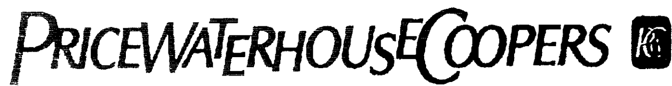
not part of the original pension terms. Any payment on death is separately assessed and taxed accordingly. In the case of the $5m cameo, all of the remaining balance in the life-time pension on death outside of any guarantee period (eg 10 years) would be taxed at 38% or 48% when paid as a lump sum to a dependant or the estate, which materially impacts the analysis. If death occurs within a guarantee period, a portion of the balance would still attract the excessive tax rate, which also materially impacts the analysis.

There may be other issues with the cameos, which I have not had time to analyse in detail yet.

I am also concerned about the accuracy and relevance of some of the information presented to the Committee by Treasury/Govt Actuary/ATO at the recent hearings. For example, in Treasury's opening statement to the 9th August 2004 hearing, they asserted that fixed term pensions can be manipulated to compress the RBL, justifying the ban on fixed term pensions as well as life-time pensions. RBL compression for a fixed term pension can only occur where the pension is not a "purchased pension" (that is, where there is no identifiable account balance when the pension is commenced). What Treasury failed to explain is that in a DIY fund, fixed term pensions are always "purchased pensions", and therefore, the RBL assessment is based solely on the purchase price – there can therefore be no RBL compression, since the pensions are assessed dollar for dollar for RBL purposes. The evidence presented to the Committee was, in my opinion, very misleading.

As another example, the ATO were very cagey about answering the questions on the retrospective nature of the recent changes, particularly with respect to adjusting a pension after 30 June 2005. The ATO have issued a draft determination SD 2004/D1 which provides that if a person receiving a defined benefit pension from a DIY fund needs to adjust their pension after 30 June 2005 for whatever reason (eg changing a beneficiary on divorce, lower than expected investment earnings, changing the indexation, etc), they cannot then re-commence their life-time pension within their DIY fund. People who entered these arrangements years ago on the basis that they were able to adjust their pension if ever required now find that they will be forced to either purchase a retail product or switch to a "growth" pension if they ever need to adjust their arrangements.

Other comments by the ATO such as *"there is a revenue loss where employers argue that they can make multimillion dollar contributions into a superannuation fund and allocate it at will"* are also unhelpful (and in my opinion, misleading) in understanding the issues. Employers can only claim deductions up to the maximum deductible limits under the Tax Act each year, being $13,934 for a person under age 35, $38,702 for a person aged between 35-49 and $95,980 for employees aged



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50 and over. How on earth can a small employer make multi-million dollar contributions in the first place without a tax penalty applying for exceeding the maximum deductible limits?

There were a number of other statements made that I question the accuracy of, but won't expand on here. If you would ever like to discuss any of these issues, or would like further clarification on anything said or presented at the Committee hearing, then please feel free to phone me at any time.

Thank you for your time.

Yours sincerely,

Cohen Watson
Fellow of the Institute of Actuaries of Australia
Director, Retirement Incomes and Asset Consulting
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