



18 June 2004

Dr Sarah Bachelard  
Secretary  
Senate Economics Committee  
Parliament House  
CANBERRA ACT 2600

Dear Dr Bachelard,

### **Budget 2004 and related legislation / regulations**

I am writing on behalf of the members of The Institute of Chartered Accountants in Australia and a group of their clients being Australian retirees who have been caught up in the uncertainty of recent policy and budget announcements. This uncertainty has been caused by the lack of clarity in the regulations. While not specifically included in the scope of this review we believe that these regulations need to be withdrawn and reintroduced following a period of consultation. In addition to the uncertainty we also wish to highlight areas where those wishing to exploit loopholes may overcome the legislative intent. The second area addressed by this submission is the discrimination arising from the exclusion of the self-employed from the government co-contribution.

#### **Concern the small funds industry is being targeted in favour of the retail sector**

A number of members have expressed concern that these measures target the smaller funds in the superannuation marketplace and give an impression that all users of these products are doing so to obtain an unfair advantage. This appears to be driven by the perception that monies are being kept for future generations in a tax favoured environment and that Reasonable Benefit Limits are being expanded.

This is in conflict with the policy of the government to encourage choice in the Australian market place. Small corporate funds restricted in the acceptance of new members and self-managed funds will be restricted in the retirement solutions they can offer. Artificial restrictions such as these decrease competition in the market place which conflicts with the governments stated intention.

We believe that the perceived 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. 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.

It is noted that those wishing to take advantage of complying pensions in order to address excessive benefits will be able to continue to do so via the purchase of a retail sector product. This matter is best addressed via an amendment to the RBL rules that link the value of funds used to commence the pension as the RBL value.



### **Recommendation**

It is recommended the government consider industry proposals to overcome problems while continuing to allow small superannuation funds to offer fixed income pensions.

It is recommended the government consult with small corporate defined benefit funds and their employer sponsors to ensure they are aware of the employee obligations associated with these funds and are prepared to continue to meet their ongoing obligations. We would also recommend the regulators provide clear guidance as to how discretion is to be applied in relation to the addition of new members.

### **Disadvantage to Australians planning to retire between 12 May 2004 and 20 September 2004**

The introduction of uncertainty in the retirement income system overnight as occurred on budget night causes particular concern to those who were planning to retire during the period 11 May 2004 and 20 September 2004. Many retirees elect to retire at the end of the financial year and would have commenced planning to give effect to this life change.

For example, a couple may have tailored their retirement plans to suit their household e.g. husband age 65 has commenced a complying pension and wife aged 60 intends to commence a pension at retirement age 62. In this circumstance the couple will need to revisit their plan to determine their future outcomes.

These individuals have sought financial advice and had plans put in place that will enable them to retire with the target level of assets at their disposal. These plans may have been made over a number of years through the development of an asset pool that meets both short-term income needs and long-term growth required when paying a lifetime complying pension. Rather than being in a position to meet these requirements through an APRA regulated fund of less than 50 members or a self managed fund they are now forced to realise the assets and purchase a retail pension product. This results in a decrease in assets available for retirement due to capital gains tax and realisation costs. It is anticipated that some of the purchased products will be commuted within 6 months of commencement and transferred to a market linked income stream within the smaller fund when these become available. When commuted the retirement benefits available are likely to be reduced as a result of fees.

The alternative to the above is for the individual to forgo the RBL benefits of taking a complying pension and to take an allocated pension. In this circumstance the member will be paying an increased level of income tax on income received during the period of the allocated pension. It is likely that the allocated pension will be commuted when market linked income streams become available to enable the individual to be reassessed for RBL purposes and take advantage of pension RBLs.

When a current pensioner dies during this period the individual will need to make similar decisions to those above in order to put in place the pension arrangements to look after minor children and spouses.

The above examples will result in increased administrative costs in order for the members benefits to be treated as complying with requirements for a pension RBL further undermining the individuals retirement income. The stopping and starting of pensions also increases the workload for the ATO's RBL team and due to the complexity of the system can result in errors.



### **Recommendation**

We consider these funds should be able to offer pensions until 20 September 2004 when market linked income streams are available or such later time, as the government determines is appropriate. While this may encourage some people to retire earlier than planned this is limited to those who meet pension requirements and commence a pension during this period.

We also recommend that the legislative amendments enabling market linked income streams be implemented as soon as practical to provide the financial planning community certainty when recommending retirement alternatives to those planning to retire in the medium term ie. in the next 1-5 years.

### **Legislative uncertainty – defined benefit plans / pensions**

1. When considering the regulations the amendment introduced by modification declaration No 23 do not appear to have been considered.

#### **Recommendation**

It is recommended that this modification declaration is withdrawn and the matters addressed by this document incorporated into the legislative changes.

2. The explanatory memorandum states that the new division 9.2B will not prevent a defined benefit pension being paid by a fund established prior to 11 May 2004 where the governing rules set out the terms and conditions of the pension prior to this legislation being introduced. Where the rules are required to be amended to specify a term or condition the new division will apply.

The description of what is intended by specifying a term or condition given by Treasury during consultation is broader than the interpretations being used in the market place. This will effectively prevent the exemption from having any effect.

#### **Recommendation**

It is recommended the terms governing rules and specifying a term or condition is clarified by the regulators to enable trustees and their advisers to determine if a pension can be commenced within the law.

3. An accumulation fund is defined as a superannuation fund that is not a defined benefit fund. A defined benefit fund is a fund with at least one defined benefit member.

A defined benefit member is a member that is "entitled on retirement or termination of his or her employment, to be paid a benefit defined, wholly or in part, by reference to either or both of the following:

- (a) The amount of:
  - (i) the members salary at a particular date, being the date of the termination of the member's employment or of the members retirement or an earlier date;  
or
  - (ii) the member's salary averaged over a period before retirement; or
- (b) A specified amount."

Consequently a member of a fund as at 11 May 2004 who was entitled to receive a complying pension on retirement was a defined benefit member and the fund was a defined benefit fund.

This would have the result of amended regulation Division 9.2A and 9.2B not applying to these funds.



### **Recommendation**

It is recommended the regulations clarify what is meant by the term "specified amount" in the definition of a defined benefit member and its application to these funds.

### Legislative uncertainty – vesting

1. Sub-regulation 5.04(2) states that for an accumulation fund that the member's minimum benefit is all of the member's benefits. Member's benefits are not defined in SIS and may lead to uncertainty where advisers use differing interpretations of the definition.

### **Recommendation**

Define the term "member's benefits"

2. Sub-regulation 5.08(2) and the EM do not make clear the governments intention that contributions allocated to a members accumulation account are not required to vest in the member where there is an existing vesting arrangement. One view put to us is that the changes to 7.08 will mean that all employer contributions must be allocated to member's benefit and hence cannot be forfeited to the benefit of other members even where there is vesting. This does not seem to be the government's intention where there is a vesting scale.

### **Recommendation**

Provide explanation / clarification by way of an example in the EM

3. Due to the definition of when a fund is a defined benefit fund there is a risk that this provision will have a limited application in relation to reg 5.04(2) and 5.08(2).

### **Recommendation**

Amend the legislation to reflect that an accumulation sub-account is to vest in the member.

### Legislative uncertainty – reserves

1. Sub-regulation 7.08 this legislation / EM does not make it clear where contributions to reserves made prior to 11 May 2004 must be allocated as soon as practicable.

### **Recommendation**

Provide explanation / clarification by way of an example in the EM

2. Sub-regulation 7.08 The legislation may enable some deferral of surcharge to a lower taxing period. Eg. a contribution made in June 2004 can be made to a reserve and allocated 28 days later. This would enable the contribution to be reported to the ATO during the 2004/05 year and also result in a lower surcharge to the member in July 2004, the surcharge attributable is at the lesser rate applying in the 2004 /05 year.

### **Recommendation**

Consider amending the regulations to close this opportunity.

3. Sub-regulation 7.08 is written with regard to an accumulation fund. A fund where 1 member is a defined benefit member is classified, as a defined benefit fund therefore the fund would be able to use reserves.

### **Recommendation**

In order to give effect to the Governments intention that all monies paid in respect to accumulation sub-accounts are allocated to members this provision should be amended.



## Discrimination against the Self Employed Superannuation - Co-contributions

### Background

The government introduced co-contribution is applicable only to employees who make an after tax (member) contribution to superannuation. Those who are self employed are not eligible for this additional contribution regardless of income.

For example - To enable a flexible return to the workforce a young woman may set up a niche business based from home. This may generate a small income for the individual. In addition to losing other government support such as family tax benefit. They also find they are ineligible for co-contributions.

### Benefits

- Improved adequacy for the self employed;
- Improved equity for the self employed relative to employees;
- Greater encouragement to save for the longer term;
- Simpler and more uniform taxation system for superannuation;
- Increased long term savings and funds available for investment.

### Cost to Government revenue

Currently around 185,000 self employed individuals claim a deduction for super contributions, with only a proportion making contributions in excess of \$5,000 this will have a small impact but would recognise all workers as equal.

### Example

An employed person with a total remuneration package of \$56,000 has an employer contribution of \$10,000 per annum made on their behalf. This contribution is made up of \$5,040 superannuation guarantee contributions and \$4,960 salary sacrifice. This is tax deductible to the employer as it is under the members age based limit. Should this person choose to make an additional post tax contribution of \$1,000 they would be eligible for the co-contribution.

A self - employed person with a total remuneration package of \$56,000 makes a contribution of \$10,000 per annum. Of this contribution only \$8,750 is tax deductible to the individual. Should this person choose to make an additional post tax contribution of \$1,000 they would not be eligible for the co-contribution.

### Potential for erroneous payment

We also note that the instructions for the completion of the members contribution statement the key piece of data for this measure are unclear and may result in payments being made to the self employed.

The tax deductible component of the self employed persons contribution have the same tax and preservation treatment as an employer contribution and are often classified as such in the superannuation funds reporting systems. The member contribution statement instructions are silent as to the correct classification for these contributions when completing the form.

Where the practitioner completes the form including these as employer contributions this may result in a co-contribution being paid to a self-employed person. This is likely to then result in cost rectification in the future. It is recommended the ATO and professional bodies educate practitioners and funds to improve the correct reporting of contributions.



Should you require further clarification on the matters above please do not hesitate to contact myself on 02 9290 5613 or Susan Orchard on 03 9502 3471.

Yours Sincerely

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in Australia