

The Senate

Standing Committee on Economics

Tax Laws Amendment (Simplified
Superannuation) Bill 2006 [Provisions]
and related bills [provisions]

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Chapter 1

Introduction

Background

1.1 On 7 December 2006 the Senate referred the provisions of the Tax Laws Amendment (Simplified Superannuation) Bill 2006 and five related bills to the Senate Standing Committee on Economics for inquiry and report by 6 February 2007.¹

1.2 The bills implement the package of reforms to simplify and streamline superannuation released as part of the 2006–07 Budget on 9 May 2006. The proposals, which are due to take effect from 1 July 2007,² represent the most significant reform to the superannuation system in decades. They will potentially affect over 10 million individuals, 1.3 million employers and more than 310,000 superannuation funds. The cost of the reforms, including additional costs associated with the transitional and administrative arrangements announced by the government in September 2006, is estimated at \$7.2 billion over four years, which is less than one per cent of Commonwealth government revenue.

1.3 The Treasurer's Budget announcement stressed that the proposals will reduce complexity, increase certainty and restore confidence in the superannuation system:

The complexity associated with taxing superannuation benefits confuses retirement decisions, clouds the incentive to invest in superannuation and imposes unnecessary costs... Government

As a result of decisions made by the then in 1988, the current superannuation system has different arrangements for tax on contributions, earnings and superannuation benefits. Superannuation benefits tax is by far the most complicated, as highlighted by the Regulation Taskforce. For example, a lump sum superannuation benefit may include up to eight different parts which can be taxed in seven different ways. If people can not understand what they will receive from their superannuation in retirement, they will not have confidence in the system.³

1 Superannuation (Excess Concessional Contribution Tax) Bill 2006; Superannuation (Excess Non-concessional Contribution Tax) Bill 2006; Superannuation (Excess Untaxed Roll-over Amounts Tax) Bill 2006; Superannuation (Departing Australia Superannuation Payments Tax) Bill 2006; and Superannuation (Self Managed Superannuation Funds) Supervisory Levy Amendment Bill 2006.

2 Limits on non-concessional contributions applied from 10 May 2006. The revised age pension arrangements will commence on 20 September 2007.

3 'A plan to simplify and streamline superannuation', Press Release, the Hon. Peter Costello MP, 9 May 2006.

1.4 The Treasurer's Budget announcement was accompanied by a detailed consultation paper providing an outline of the proposed changes, describing how the new system would operate and inviting public comment on the changes.⁴ During the three month consultation process, Treasury received more than 1500 written submissions and 3500 phone calls and government officials met with representatives of the superannuation industry and related bodies. In September 2006, the government released a final proposals paper which described the outcome of the consultation process.⁵ The government confirmed that it would proceed with key changes included in the initial plan and with arrangements to make the transition to the new system easier, improve administration and improve the integrity of the superannuation system.⁶

1.5 The government announced that regulations supporting the bills will be introduced after they receive Royal Assent. Consequential amendments, including the formal repeal of old laws, will be included in another bill to be introduced in the Parliament in early 2007.

Conduct of the inquiry

1.6 The committee advertised the inquiry in the *Australian* newspaper on 12 December and invited written submissions by 15 January 2007. Details of the inquiry, the bills and associated documents were placed on the committee's website. The committee also wrote to a number of organisations and stakeholder groups inviting written submissions.

1.7 The committee received 21 submissions and 9 pieces of correspondence. A public hearing was held in Canberra on 30 January 2007. Witnesses included representatives from superannuation industry associations, accounting professionals, Treasury and Australian Tax Office (ATO) officials and private individuals. The committee explored with witnesses areas of concern contained in written submissions, including concerns that had previously been raised with the government following the announcement of the reforms in May 2006.

1.8 This report reflects the committee's approach. The remainder of Chapter 1 summarises the policy objectives and key elements of the legislation. Chapter 2 describes in detail the main provisions of the bills and how the new tax arrangements will work in practice. Chapter 3 examines a number of contentious issues raised in submissions to this inquiry, many of which were previously raised with Treasury as part of its consultation process held during the second half of 2006. The report concludes with the committee's findings and recommendations.

4 *A Plan to Simplify and Streamline Superannuation: Detailed Outline*, The Treasury, May 2006.

5 *A Plan to Simplify and Streamline Superannuation: Outcomes of Consultation*, The Treasury, 5 September 2006.

6 A list of transitional arrangements is included in 'Simplified superannuation – final decisions', Press Release, the Hon. Peter Costello MP, 5 September 2006, p.2.

Purpose and objectives of the bills

1.9 The changes included in this omnibus legislation are considered necessary against the backdrop of a superannuation system which has become increasingly complicated and difficult to navigate, as a result of changes to tax arrangements introduced over the last two decades. The government's press release announcing the introduction of the bills in Parliament stated that the reforms '...will sweep away the current raft of complex tax arrangements that apply to superannuation and cut the number of pages of superannuation law in the income tax assessment Acts by over a third'.⁷

1.10 To this end, the bills rewrite superannuation taxation law into the *Income Tax Assessment Act 1997* and consolidate provisions that are currently located in different parts of existing legislation and which are in no logical sequence. The Explanatory Memorandum states:

This rewrite provides a clearer picture of the taxation treatment of superannuation savings across the life of the superannuation investment: when the money is contributed; during the investment phase; and at the end benefit payment phase, and provides a consistent style.⁸

1.11 This improvement will present a clear and logical picture of the taxation of superannuation. The best example of this simplification relates to the tax treatment on superannuation benefits for the more than 90 per cent of people in taxed superannuation schemes. Under new subdivision 301-B of the simplified superannuation bill, the tax treatment on superannuation benefits is covered in one simple paragraph.

1.12 The detailed outline released by the government in May 2006 stated that the proposals would simplify superannuation arrangements for retirees and make them easier to understand, improve incentives to work and save, and introduce greater flexibility in how superannuation savings can be drawn down in retirement. The overriding policy objectives for the more than 10 million Australians with superannuation accounts and future account holders are to sustain workforce participation, increase retirement savings and simplify tax arrangements on superannuation.⁹ The Treasurer's second reading speech provided a fuller explanation of the policy objectives:

The simplified superannuation reforms will encourage people to take a greater interest in their superannuation and give people greater confidence to make additional savings. The earlier people contribute, the greater the

7 'Simplified superannuation legislation introduced into Parliament', Joint Press Release, Treasurer, Minister for Revenue and Assistant Treasurer, 7 December 2006.

8 Tax Laws Amendment (Simplified Superannuation) Bill 2006 and related bills, Explanatory Memorandum, p.5.

9 *A Plan to Simplify and Streamline Superannuation: Detailed Outline*, The Treasury, May 2006, p.vii.

benefits they will be able to reap from the low-tax and long term investment environment available in the superannuation system.

The amendments in the [Simplified Superannuation Bill 2006] are also an important part of the Government's commitment to reduce the complexity of the tax law, regulatory burdens and compliance costs faced by taxpayers.¹⁰

1.13 The government has stressed the significance of the reforms included in the proposed legislation. As the Treasurer has stated, the bills represent a substantial investment by the government in the living standards of Australians in retirement and in addressing the challenges of an ageing population. The changes also form an important part of the government's response to the report of the Taskforce on Reducing Regulatory Burdens on Business, *Rethinking Regulation*, which recommended that high priority be given to simplifying the tax rules for superannuation. In its submission, the Association of Superannuation Funds of Australia endorsed the government's proposal as 'represent[ing] a major simplification of the superannuation system.'¹¹

Simplified superannuation: summary of main proposals

1.14 The centrepiece of the simplified superannuation bill is that superannuation benefits paid from a taxed fund, either as a lump sum or as an income stream such as a pension, will be tax free for people aged 60 and over. The bills will also introduce other key measures:

- reasonable benefit limits (RBLs) will be abolished;
- individuals will have greater flexibility as to how and when to draw down their superannuation in retirement. There will be no forced payment of superannuation benefits;
- age-based restrictions limiting tax deductible superannuation contributions will be replaced with a streamlined set of rules including:
 - the level of contributions to superannuation receiving concessional tax treatment will be limited to \$50,000 per person per financial year;
 - personal superannuation contributions from an individual's post-tax income will be limited to \$150,000 per financial year or \$450,000 for a three year period;
- the self-employed will be able to claim a full deduction for their superannuation contributions as well as being eligible for the government co-contribution for their after-tax contributions;

10 The Hon. Peter Costello MP, Second Reading Speech, Tax Laws Amendment (Simplified Superannuation) Bill 2006, 7 December 2006.

11 Association of Superannuation Funds of Australia, *Submission 6*, p. 1.

- the ability to make deductible superannuation contributions will be extended up to age 75;
- the pension assets test taper rate will be halved to \$1.50 per fortnight for every \$1000 of assets above the relevant threshold; and
- individuals will have until 30 June 2008 to quote their tax file number (TFN) before the highest marginal tax rate is imposed on concessional contributions.

1.15 When the simplified superannuation and related bills were introduced in the Parliament, the Treasurer announced a series of measures to enhance the policy and administrative framework to ensure that individuals receive the full benefit from their superannuation savings (see Chapter 2 for details). These measures will make it easier for people to find and transfer their superannuation between funds.

1.16 The government in addition will take full responsibility for the management of unclaimed, or lost, superannuation which means that in future unclaimed superannuation money will not be paid to the states and territories.¹² The ATO will be provided with a significant increase in resources to reduce the amount of money held in lost accounts and provide individuals with advice on superannuation-related issues. According to the Treasurer, this new measure:

...is consistent with the arrangements for lost superannuation and provides a single access point for individuals searching for lost or unclaimed superannuation and a simpler nationalised claims process going forward. As a result, individuals will be able to seek advice directly from the ATO on any superannuation-related issue, without having to contact numerous government agencies.¹³

12 This change will not affect state and territory superannuation schemes.

13 The Hon. Peter Costello MP, Second Reading Speech, Tax Laws Amendment (Simplified Superannuation) Bill 2006, 7 December 2006.

Chapter 2

Key provisions and overview

2.1 This chapter explains the main provisions of the bills and how the new tax arrangements would work in practice. The following aspects of the bill are considered in approximately the same order they appear in Explanatory Memorandum:

- Streamlined contribution arrangements
- Taxation of superannuation benefits
- Tax File Numbers
- Employment termination payments
- Self-employed provisions
- Age pension arrangements
- Regulation of self-managed superannuation funds
- Portability
- Unclaimed superannuation

Streamlined contribution arrangements

2.2 The bill seeks to implement a range of measures to simplify and streamline the existing contribution arrangements, for example the removal of age-based limits on concessional contributions and the deductibility of employer contributions.

2.3 As is the case under the current taxation system, the tax treatment of superannuation contributions would vary depending upon whether they were made from a pre-tax or post-tax income. Below is an overview of the proposed streamlined contribution arrangements. The topic is divided into concessional (pre-tax) and non-concessional (post-tax) contributions.

Concessional contribution

2.4 Concessional contributions essentially refer to superannuation contributions that are made from pre-tax income. Examples of concessional contributions include employer superannuation guarantee contributions, additional employer contributions, salary sacrifice contributions and contributions made by the self-employed for which they claim a tax deduction.

2.5 If the bill passes, a new annual cap for concessional contributions would be set at \$50 000 per person (irrespective of age) from 1 July 2007. This single cap will

replace the multiple thresholds that make up the current age-based limits.¹ The concessional contributions cap is set at around the average of the current age-based limits. The new cap will apply irrespective of the number of employers contributing on behalf of the person. The cap will be indexed annually in \$5000 increments.²

2.6 Such contributions will be taxed at the concessional rate of 15 per cent (equivalent to the existing rate). Earnings from concessional contributions will continue to be taxed at the notional concessional rate of 15 per cent.

2.7 Excess concessional contributions (that is, contributions made from pre-tax income in excess of the annual \$50 000 cap) will be effectively taxed at the top marginal tax rate plus the Medicare levy (a total of 46.5 per cent). This is essentially the same arrangement for contributions that exceed the age-based limits under the current system.

2.8 Tax liabilities for excess concessional contributions will be levied on fund members. The individual can elect for their superannuation fund to release some of the monies held in their account to pay the tax liability.³

2.9 Excess concessional contributions will be counted towards the non-concessional cap (discussed below) to ensure that people cannot circumvent the non-concessional cap by making excessive concessional contributions.

2.10 A five year transitional cap of \$100 000 per annum will apply to anyone aged 50 and over at the end of a financial year, in the period 2007–08 to 2011–12. The transitional cap has been set at a similar level to the current system's age-based limit for individuals aged 50 and over. This arrangement will enable those planning to retire soon to make larger contributions at concessional rates. Unlike the concessional contribution cap, the transitional cap will not be indexed.⁴

2.11 Several items will be expressly excluded from an individual's concessional contributions including transfers of investment earnings on foreign superannuation benefits while an individual was an Australian resident.⁵

2.12 The deduction rules that currently apply to employers and the self-employed arrangements will be simplified as all contributions to superannuation funds on behalf of employees under the age of 75 will be fully deductible.

1 The annual age-based limits for 2006–07 are \$15 260 for people under 35 years; \$42 385 for people aged 35–49 years; and \$105 113 for people 50 years and over.

2 Explanatory Memorandum, p. 21.

3 Explanatory Memorandum, p. 38.

4 Explanatory Memorandum, p. 23.

5 Other categories of excluded contributions are outlined in the Explanatory Memorandum at page 22.

Non-concessional contribution

2.13 Currently there are no limits on the amount of post-tax contributions that can be made each year. The removal of the benefits tax (for people aged 60 and over) and the abolition of reasonable benefits limits will increase the concessions provided to superannuation and therefore increase its appeal as an investment option. The changes will make superannuation an attractive vehicle in which to retain assets to avoid paying tax. There will also be an incentive for high-wealth individuals to transfer large amounts of assets currently held outside superannuation to the favourably taxed superannuation system.

2.14 To ensure the concessions are targeted appropriately, a cap of \$150 000 per person per annum on non-concessional superannuation contributions will apply from 1 July 2007. The non-concessional cap will remain at three times the level of the concessional contributions cap and will increase as the concessional cap moves with indexation.⁶

2.15 To provide greater flexibility to larger contributors, people under the age 65 will be able to bring forward two years worth of future entitlements, giving a cap of \$450 000 over three years.⁷

2.16 No tax will be payable on non-concessional contributions that fall below these caps. Earnings from non-concessional contributions will continue to be taxed at the notional concessional rate of 15 per cent.

2.17 A transitional cap of \$1 million on non-concessional contributions will apply between 10 May 2006 and 30 June 2007. These arrangements will allow people who were planning larger contributions under the existing rules to continue with their plans.⁸

2.18 The proposed level of the non-concessional contributions cap appears generous and according to the Treasury 'is expected to impact on very few people'.⁹

2.19 Excess non-concessional contributions will be taxed at the top marginal tax rate plus the Medicare levy (a total of 46.5 per cent). To ensure that people cannot circumvent the non-concessional cap by making excessive concessional contributions, excess concessional contributions will count towards the non-concessional cap.

2.20 The bill proposes two exemptions from the non-concessional cap:

6 Explanatory Memorandum, p. 25.

7 Explanatory Memorandum, p. 26.

8 Explanatory Memorandum, p. 32. To be eligible for the transitional cap those aged 65–74 must satisfy the 'work test' set out in the *Superannuation Industry (Supervision) Regulations 1994*.

9 *A Plan to Simplify and Streamline Superannuation: Detailed Outline*, The Treasury, May 2006, p. 30.

- the proceeds from the disposal of assets that qualify for the small business capital gains tax exemptions up to a lifetime limit of \$1 million (indexed); and
- the proceeds from a settlement for an injury resulting in permanent disablement.¹⁰

2.21 The tax liability arising from excess non-concessional contributions must be paid from a member's superannuation account.¹¹

Taxation of superannuation benefits

2.22 The proposed changes seek to provide greater incentives to invest in superannuation by simplifying the arrangements for the taxation of benefits and reducing the amount of tax levied from benefits paid. The Explanatory Memorandum to the bills states:

The complexity of these [current] arrangements affects the ability of individuals to make decisions relating to their retirement and adds to the administration costs for superannuation funds.¹²

2.23 As a general rule the taxation of superannuation benefits depends on the age of the member.

Taxed funds

2.24 The most significant change is the removal of tax on superannuation benefits paid to people aged 60 and over when paid from a 'taxed' superannuation fund (where the benefits have already been subject to tax on contributions and earnings). These funds contain around 90 per cent of Australian employees and are typically private sector accumulation funds. The removal of tax on benefits for this age category applies to both lump sum payments and superannuation income stream payments.

2.25 Presently, the taxation arrangements for those aged 60 and over and receiving lump sum superannuation benefits are more complex:

Superannuation lump sum benefits paid from a taxed source comprise up to eight different components that are each subject to different taxation arrangements.¹³

2.26 Marginal tax rates with a 15 per cent tax offset are presently applied to superannuation income stream payments from a taxed source.

10 Explanatory Memorandum, p. 29.

11 Explanatory Memorandum, p. 39.

12 Explanatory Memorandum, p. 44.

13 Explanatory Memorandum, p. 51.

2.27 Removing taxes on benefits for the 60 and over category is designed to provide a substantial incentive for people to remain in the workforce until then, rather than opting out at the preservation age.¹⁴ Consequently, for those aged between the preservation age and 59, superannuation benefits will remain subject to tax. However, the varying tax treatment of different benefit components will be simplified and in some cases reduced, leaving an exempt component and a taxable component.¹⁵ The exempt component will be tax free.

2.28 For lump sum payments to those aged 55 to 59, the taxed component will be tax free up to the low rate threshold, beginning at \$140 000 on 1 July 2007 and indexed in \$5000 amounts. Beyond this amount, lump sum benefits will be taxed at 15 per cent. Pension payments to this category of recipient will be taxed under the current arrangements, at marginal tax rates with a 15 per cent offset, though subject to the simplification of benefit components also applying to lump sum payments.¹⁶

2.29 Lump sum superannuation benefit payments to those aged under 55 will be taxed at 20 per cent, with no tax free threshold. Superannuation income streams for this category will simply be taxed at marginal rates with no tax offset.

Untaxed funds

2.30 Benefits that have an untaxed element (typically payments from an untaxed fund) will still be subject to tax.¹⁷ 'Untaxed' funds are generally a component of public sector defined benefit funds. The amount of tax applied to untaxed earnings is explained at page 47 of the Explanatory Memorandum.

2.31 Although this category of benefits will continue to be taxed, the arrangements proposed are more generous than those currently in place for those who receive a lump sum in excess of the current low rate threshold.¹⁸ In addition, untaxed benefits received as an income stream by those 60 and over will be entitled to a 10 per cent tax offset not currently applied.¹⁹

14 From 2015 until 2024 the preservation age will be incrementally increased from 55–60.

15 These are outlined in further detail at Treasury, *A plan to simplify and streamline superannuation: Detailed outline*, May 2006, p. 14.

16 Treasury, *A plan to simplify and streamline superannuation: Detailed outline*, May 2006, pp 13–15. See also Explanatory Memorandum, p. 46.

17 Explanatory Memorandum, pp 45 and 47. See also Treasury, *A plan to simplify and streamline superannuation: Outcomes of consultation*, September 2006, pp 24–25.

18 Explanatory Memorandum, p. 51. Lump sums above this threshold (\$135 590 in 2006–07) are taxed at 30 per cent and at marginal rates above the RBL.

19 Explanatory Memorandum, p. 51.

Reasonable benefit limits

2.32 Reasonable benefit limits (RBLs), which presently restrict the benefit amount that is subject to concessional tax treatment, will be abolished if these measures are enacted.²⁰

Tax File Numbers

2.33 Currently, there is no requirement for a person to quote their tax file number (TFN) before making a contribution to a superannuation fund. Under the new system, it is proposed that in cases where a TFN has not been quoted to a taxed fund, the top marginal tax rate of 46.5 per cent (31.5 per cent on top of the 15 per cent of tax on contributions) will apply where taxable contributions to that fund for a member exceed \$1000 per annum.²¹ The additional tax will be refunded if TFNs are quoted within the subsequent three year period.²² Interest on the additional no-TFN tax may also be payable by the ATO where an employer fails to inform the superannuation provider of the individual's TFN before the end of the financial year.²³

2.34 The provision of TFNs is important for the effective administration of the new superannuation system, particularly enforcing the new superannuation contribution caps. The Treasurer's second reading speech on the bills stressed the importance of TFNs to the operation of the new system:

In order to ensure the integrity of the generous taxation concessions given to superannuation, it is necessary to ensure that tax file numbers are quoted for as many superannuation accounts as possible. Increased TFN quotation will also, over time, lead to better matching of people with their lost superannuation benefits.²⁴

2.35 According to the Treasury, new arrangements will be put in place to minimise the number of accounts subject to the additional tax:

...the legislation will be amended so that where an employee quotes a TFN for employment purposes it is automatically taken to be quoted for superannuation purposes. Generally, the employer must pass this onto a superannuation fund within 14 days of the TFN being quoted. Enforcement

20 In 2006–07 the lump sum RBL was \$678 149 and pension RBL \$1 356 291. Further information is available at www.ato.gov.au/super.

21 The no-TFN tax is specified under new section 29 on the *Income Tax Rates Act 1986*. The \$1000 threshold is provided for under new section 295-610 of the *Income Tax Assessment Act 1997*. According to new paragraph 295-610(2)(a) the \$1000 threshold will not apply for accounts opened on or after 1 July 2007.

22 New section 295-675.

23 New section 8ZD of the *Taxation (Interest on Overpayments and Early Payments) Act 1983*.

24 The Hon. Peter Costello MP, Second Reading Speech, *Tax laws Amendment (Simplified Superannuation) Bill 2006*, 7 December 2006.

of this requirement will move from the Australian Prudential Regulation Authority to the ATO.

Where possible, the ATO will use its systems to match TFNs to members where non-quotation has occurred and contact members to organise for a TFN to be provided to their superannuation fund. The ATO will also undertake an education campaign to encourage members to provide their TFN to the fund.²⁵

Employment termination payments

2.36 As a consequence of the proposed abolition of RBLs and changes to taxes on benefits, the concessional tax treatment for employment termination payments is also subject to amendment. Currently, such payments are counted with superannuation benefits when assessing concessional treatment within RBLs. In the absence of RBLs under the new arrangements, the following concessional caps are proposed:

Employer ETPs will be comprised of two components — exempt and taxable. The exempt component will be any post-June 1994 invalidity amount and the pre-July 1983 amount. This will be exempt from tax. The taxable component will be the post-June 1983 amount. This will be taxed at 15 per cent for amounts up to \$140,000 (indexed) for recipients aged 55 and over and at 30 per cent for those aged under 55. Amounts in excess of \$140,000 will be taxed at the top marginal tax rate (plus Medicare levy). These arrangements will apply per termination and any payment must be made within one year of termination.²⁶

2.37 The current tax treatment of genuine redundancy payments, early retirement scheme payments or unused leave will remain unchanged.²⁷

2.38 Given the aforementioned changes to taxes on benefits, employment termination payments will not be permitted to be rolled over into superannuation. However, transitional arrangements will apply to payments specified in employment contracts in existence as at 9 May 2006.²⁸

Self-employed provisions

2.39 Two measures designed to provide greater incentives for the self-employed to contribute to superannuation have been proposed.

25 Treasury, *A plan to simplify and streamline superannuation: Outcomes of consultation*, September 2006, pp 22–23.

26 Treasury, *A plan to simplify and streamline superannuation: Outcomes of consultation*, September 2006, p. 21.

27 Treasury, *A plan to simplify and streamline superannuation: Outcomes of consultation*, September 2006, p. 22. Superannuation benefits are not included in employment termination payments.

28 Treasury, *A plan to simplify and streamline superannuation: Outcomes of consultation*, September 2006, p. 21.

Contributions tax deductibility

2.40 These measures will allow the self-employed to claim a full deduction for superannuation contributions until the age of 75. Consequently, contributions made by the self-employed will be treated in the same way as those made for the benefit of employees.

2.41 Presently, only the first \$5000 per year is fully deductible. Beyond that amount, contributions are 75 per cent tax deductible up to age-based limits.²⁹

Accessing the co-contributions scheme

2.42 Should the bills be passed, access to the co-contribution scheme would be extended to the self-employed. Presently, they are not eligible unless 10 per cent or more of their income is earned as an employee.³⁰ According to Treasury:

The Government co-contribution scheme will be extended to the self-employed, effective from 1 July 2007 provided they satisfy the existing eligibility criteria for the co-contribution.

To provide for the self-employed, income will be determined by adding the assessable income of an individual (including any reportable fringe benefits, if applicable) and then reducing that amount by their expenses incurred in carrying on a business.³¹

Age pension arrangements

2.43 The design of the age pension system has important implications for incentives to work and save for retirement. The eligibility for the age pension is determined primarily by two factors – the income test and assets test. The age pension is generally paid on the lower amount resulting from these two tests.

2.44 The income test is relatively generous. A single person can earn up to \$36 000 per annum and still be eligible for a part-rate pension.

2.45 Under the current assets test, a person loses \$3 per fortnight for every \$1000 of assets above the relevant threshold.³² The Treasury noted that the 'high [assets test] withdrawal rate creates a disincentive to save and build retirement savings.'³³

29 Treasury, *A plan to simplify and streamline superannuation: Detailed outline*, May 2006, p. 33.

30 Explanatory Memorandum, p. 176.

31 Treasury, *A plan to simplify and streamline superannuation: Outcomes of consultation*, September 2006, p. 18.

32 Current threshold rates are \$161 500 for single homeowners; \$229 000 for couple homeowners; \$278 500 for single non-homeowners and \$346 000 for couple non-homeowners.

33 *A Plan to Simplify and Streamline Superannuation: Detailed Outline*, The Treasury, May 2006, p. 37.

2.46 The bill will halve the pension assets test taper rate so that Age Pension, Service Pension and other pension recipients will only lose \$1.50 a fortnight for every \$1000 of assets above the relevant threshold, effective from 20 September 2007. This change will increase the entitlement of those already receiving a part pension and also increase the number of people eligible for the part pension and the associated concessions.

2.47 When he introduced the bill, the Treasurer explained the beneficial financial impact of the reduced pension assets test taper rate:

Pensioners currently have to achieve an after-tax return of 7.8 per cent on their additional savings; otherwise they lose more age pension than they generate in income on their savings. The halving of the taper rate will reduce the break-even rate of return to 3.9 per cent.³⁴

2.48 The reduced assets test taper rate will apply to the following payments:

- Age and service pensions;
- Disability support pension;
- Carer payment;
- Wife pension;
- Widow B pension; and
- Bereavement allowance.

2.49 To properly target the proposed change to the assets test taper rate a consequential change to the current 50 per cent assets test exemption for 'complying' income streams is also required. The Treasury noted that '[r]etaining the assets test exemption alongside the reduced assets test withdrawal rate would create scope for wealthier individuals to access the age pension.'³⁵ The bill will remove the 'complying income streams' exemption for future income streams purchased on or after 20 September 2007. The assets test treatment of income stream products purchased before 20 September 2007 will not change.

Regulation of self-managed superannuation funds

2.50 The bill will amend the *Superannuation Industry (Supervision) Act 1993* and other Acts to enhance the regulation of self-managed superannuation funds (SMSFs) and to ensure that self-managed superannuation funds comply with their legislative obligations. These proposed changes were not included in the original policy

34 The Hon. Peter Costello MP, Treasurer, Second Reading Speech, Tax Laws Amendment (Simplified Superannuation) Bill 2006, *House of Representatives Hansard*, 7 December 2006, p. 1.

35 *A Plan to Simplify and Streamline Superannuation: Detailed Outline*, The Treasury, May 2006, p. 39.

announcement of May 2006, but instead in the *Outcomes of Consultations* document in September 2006.

2.51 The key changes to the sector include:

- streamlined reporting arrangements, by moving to a single annual requirement;
- the introduction of administrative penalties for late returns and false or misleading statements, which currently do not apply to SMSFs;
- enhanced regulation through increased ATO compliance activity;
- clarification of trustee requirements so that directors of corporate trustees cannot receive remuneration for trustee duties or be appointed as the legal representative of a disqualified person;
- clarification of auditor requirements so that auditors report on specified matters to the Regulator; and
- an increase in the supervisory levy from \$45 to \$150 per annum.³⁶

Portability

2.52 The bill introduces measures to simplify the transfer of superannuation benefits between funds and improve arrangements in respect of lost and unclaimed superannuation. Two new initiatives will make it easier for individuals to transfer superannuation benefits between funds and take more control of their superannuation, and reduce processing delays.

2.53 First, all funds will be required to use a new standardised form for portability to facilitate the transfer of benefits between funds. This will include standard proof of identity requirements to ensure uniformity between funds. Second, the maximum time period in which this transfer must occur will be reduced from 90 days to 30 days. The 30 day period will commence after a person has provided all necessary information. Trustees will also be required to follow up incomplete requests for transfers promptly.³⁷

Unclaimed superannuation

2.54 The government has provided a significant increase in resources for the ATO to further improve the operation and effectiveness of the current lost member arrangements. A number of measures will be phased in to improve the operation of the Lost Member Register and reduce the number of people listed on it, including:

36 Explanatory Memorandum, pp 157–171.

37 Treasury, *A plan to simplify and streamline superannuation: Outcomes of consultation*, September 2006, p. 27.

- rationalising existing processes to identify actual lost members including redefining lost members to exclude inactive accounts and more comprehensive reporting from funds;
- allowing accounts of less than \$200 to be paid tax free;
- an extensive letter campaign to lost members commencing in 2007 with lost account reviews to be conducted over a four year period through a combination of phone calls and letters;
- establishing a web-based tool through which members can locate their lost accounts using their TFN;
- by 2009–10, enabling members to electronically request consolidation of their accounts through the ATO website.³⁸

38 Simplified Superannuation – Frequently Asked Questions, *Portability and Lost Member Register*, <http://simplersuper.treasury.gov.au/faq/html/portability.asp>.

Chapter 3

Issues raised in evidence

3.1 Submitters were at pains to point out that overall the superannuation simplification package was a very welcome development. For example the following four quotes:

[W]e believe that the proposal is the most welcome development in Superannuation policy since its initial inception.¹

We believe these changes will significantly simplify Australia's superannuation system and help improve the retirement savings of many Australians.²

Overall the package represents a significant advancement for the superannuation system.³

The measures contained in this package will significantly simplify the current complex tax arrangements and restrictions that apply to superannuation benefits. They represent a significant step forward in improving public understanding of the superannuation system and providing greater incentives to save for retirement.⁴

3.2 The Australian Chamber of Commerce and Industry (ACCI) sounded the main note of caution in relation to the longer-term fiscal implication of the package, suggesting that it:

...supports the Government's plan as long as it is fiscally sustainable. It is not clear whether this is correct. If the costs are large, it is possible that the plan will mean the deferral or cancellation of tax reforms that ACCI considers to be a greater priority.

Therefore, ACCI urges the Government to develop a long-term cost of the plan...⁵

3.3 According to the Explanatory Memorandum the bill will have a total cost to government revenue of \$7.2 billion over four years (including \$0.5 billion in administration costs). The table below shows the annual impact on the fiscal balance.

1 National Institute of Accountants, *Submission 13*, p. 1.

2 CPA Australia, *Submission 17*, p. 1.

3 Association of Superannuation Funds of Australia, *Submission 6*, p. 1.

4 Investment & Financial Services Association, *Submission 18*, p. 1.

5 Australian Chamber of Commerce and Industry, correspondence received 18 January 2007, pp 1–2. The Australian Council of Social Service also supported this view, *Submission 21*, p. 1.

Figure 1—Impact on fiscal balance (\$ billion)⁶

2006–07	2007–08	2008–09	2009–10
-0.1	-2.2	-2.3	-2.6

3.4 Although the government has not provided a long-term projection of the impact of the package on government revenue, the Institute of Actuaries of Australia provided a forward estimate in relation to one of the key dimensions of the package; the removal of benefits tax. The Institute projected the benefits tax would have increased from 0.05 per cent of GDP (or \$0.5 billion) in 2006–07 to 0.33 per cent of GDP by 2040. Although this would represent a reasonably significant increase, relative to the projection of 1.08 per cent of GDP in 2040 for other sources of superannuation taxation (i.e. contributions tax and investment tax) the proportion is still small.⁷ The Institute summed up its findings in the following way: '...benefits taxes are destined to remain much smaller than contributions and investment taxes well into the future.'⁸

3.5 In the overall context of government revenue the benefits tax is currently a relatively small part of overall revenue (around 0.2 per cent in 2006–07). The Institute's projections suggest that this figure would increase gradually to around 1.5 per cent in 2041–42.⁹

3.6 The Australian Council of Social Service (ACOSS) highlighted the potential for greater 'income inequality in retirement' resulting from the package, stating:

...most current low and middle income retirees would not benefit significantly from the removal of taxes from benefits because their superannuation income falls below the thresholds at which taxes on benefits currently take effect. However, there are substantial tax savings for the present cohort of high income retirees. While this is not a reason in itself to reject the package, their effects on income distribution should be fully modelled so that the Parliament can consider changes to offset any likely increase in income inequality that might be identified.¹⁰

3.7 The Australian Institute of Superannuation Trustees supported the view that many working Australians are unlikely to benefit from the changes, particularly in the short term. It pointed out that the:

6 Explanatory Memorandum, p. 6.

7 Institute of Actuaries of Australia, *Submission 7*, p. 3.

8 Institute of Actuaries of Australia, *Submission 7*, p. 4.

9 Figures derived from Institute of Actuaries of Australia, *Submission 7*, p. 5.

10 Australian Council of Social Service, *Submission 21*, p. 2.

...average superannuation account balance is approximately \$80,000. Given that members who had reached their preservation age currently are entitled to receive \$135,590 tax free...then the “average Australian” would have received their benefit tax free in any event...¹¹

3.8 Submitters raised a range of issues relating to the finer details of the legislative package that were of interest to the committee. The rationale for suggesting changes included improvements to administrative efficiency, implementation, operational and equity outcomes. The issues are broadly categorised according to the following subject headings:

- Contributions
- Taxation of superannuation benefits
- Tax File Numbers
- Employment Termination Payments

Contribution issues

3.9 A range of issues were raised relating to the proposed contribution rules including the following issues which are discussed below:

- Transitional arrangements for concessional contributions
- Transfers of foreign superannuation benefits
- Timing of excess contributions tax debts
- Deductibility of superannuation contributions
- Payments to former employees

Transitional arrangements for concessional contributions

3.10 Several submitters recommended that the committee consider indexing the \$100 000 transitional cap or extending the 5 year transitional period that will apply to concessional contributions made by those aged 50 and over. For example the Association of Superannuation Funds of Australia (ASFA) argued that not indexing the transitional cap will erode its value 'effectively reduc[ing] the additional contribution [above the \$50 000 concessional contribution cap] a person turning 50 can make in a year from \$50 000 to \$45 000' by 2012.¹²

3.11 CPA Australia endorsed the indexation proposal and went further, suggesting an extension of the transition period until 2017–18:

11 Australian Institute of Superannuation Trustees, correspondence received 19 January 2007, p. 2.

12 Association of Superannuation Funds of Australian, *Submission 6*, p. 3. This assumes that the concessional contribution limit reaches \$55 000 in 2011–12.

CPA Australia believes the transitional limit for individuals aged 50 and over should be increased to \$100,000 for 10 years and should also be indexed in line with the other contribution limits. This would permit more people, especially those in the over 50 group, who could have contributed the higher amount and had planned to, to fulfil their retirement savings plans.¹³

3.12 These proposals will benefit high wealth individuals over other retirees as a contribution of \$100 000 per annum is beyond the financial means of most Australians. Under the new package, individuals aged 50 and over who could have contributed at a slightly higher level during the transitional period,¹⁴ will still receive a significant financial advantage as their superannuation benefits will be tax free and not capped by reasonable benefit limits. Furthermore, these individuals will have the ability to make non-concessional contributions of \$150 000 per annum and also have the opportunity to take advantage of the transitional period to invest up to \$1 million in post-tax contributions prior to 30 June 2007.

Committee view

3.13 The committee considers that there ought to be limits on the level of contributions that are treated at concessional rates, particularly accompanying the removal of benefits tax and reasonable benefit limits. The committee is of the view that the package as it stands is generous and strikes the right balance to encourage greater saving for retirement and prolonged workforce participation. Consequently, the committee does not recommend any changes to the proposed transitional arrangements for concessional contributions.

Transfers of foreign superannuation benefits

3.14 The proposed treatment of transfers of superannuation benefit from foreign funds was an issue raised by a number of submitters. These organisations argued that transfers from overseas superannuation funds should be excluded from the contributions caps.

3.15 For instance PricewaterhouseCoopers expressed its concern that:

...the proposals, in their current form, will penalise residents intending to retire in Australia, through the application of the non-concessional contribution limits, effective from 9 May 2006.

Under the proposed legislation the non-concessional contribution element of a transferred benefit will generally be made up of the following:

13 CPA Australia, *Submission 17*, p. 3. The National Institute of Accountants proposed an extension of the transition period until 2014–15, National Institute of Accountants, *Submission 13*, p. 3.

14 Under the current age-based limits which are proposed to be abolished those aged 50 and over can contribute around \$5000 per annum above the transitional limit.

- the benefit entitlement on the day the person first became an Australian resident...;
- employee contributions since residency; and
- employer contributions since residency...

In our extensive experience, this non-concessional component – particularly those with long service – will exceed the proposed ongoing limits. The imposition of penal tax on exceeding the limit can result in an overall effective tax rate of up to 77%.¹⁵

3.16 The Small Independent Superannuation Funds Association pointed out that transfers of foreign superannuation benefits are generally required to be paid into an Australian superannuation fund (rather than into some other form of investment). It submitted:

...that [from overseas superannuation arrangements] transfers are typically required (and not necessarily chosen) to be paid directly to an approved superannuation fund in Australia and only have a non-concessional (undeducted) contributions component by default, not design.¹⁶

3.17 The Institute of Chartered Accountants in Australia raised what it saw as a practical issue:

Where the capital value of a UK pension entitlement exceeds \$450,000 this benefit cannot be transferred to Australia when people migrate, as the UK pension fund is required to pay the benefit as a single payment to an approved fund.¹⁷

3.18 Treasury officials gave evidence that the contribution caps will affect very few individuals seeking to transfer superannuation benefits from overseas:

the vast majority of overseas transfers could be accommodated within both the \$1 million transitional cap up until 30 June this year and then the ongoing \$450,000 index[ed] non-concessional cap...¹⁸

3.19 Furthermore, Treasury officials pointed out the need for anti-avoidance measures to prevent individuals from intentionally setting up an overseas fund in order to circumvent the contribution caps:

15 PricewaterhouseCoopers, *Submission 3*, p. 2.

16 Small Independent Superannuation Funds Association, *Submission 14*, p. 1.

17 Institute of Chartered Accountants in Australia, *Submission 20*, p. 2. However, this does not appear to be strictly the case as the \$450 000 figure is not an absolute limit. New sections 292-80 and 292-85 would allow foreign transfers (and other large domestic contributions) of over \$450 000 spread across three financial years, with contributions in excess of the \$450 000 limit taxed at the top marginal rate.

18 Mr Trevor Thomas, Principal Adviser, Superannuation, Retirement and Savings Division, Department of the Treasury, *Committee Hansard*, 30 January 2007, p. 52.

There was a lot of concern about the potential for abuse in putting in special arrangements for overseas transfers. We have had experience in the past with, for example, the controlling interest arrangements some years ago...where people were making contributions to overseas superannuation funds to avoid limits in Australia... The government had to introduce changes to limit that.¹⁹

3.20 Finally, Treasury officials noted the difficulties in devising anti-avoidance measures that would cater for the various arrangements in different countries:

To put a regime in place which had regard to particular circumstances of all the jurisdictions would have been a very complex exercise, and the government took the view it could not be justified given the evidence.²⁰

3.21 IFSA proposed a practical solution to defer consideration of this issue to a later stage, noting:

...as [an acceptable solution] could take some time due to the need for these anti-avoidance measures, it may have to be addressed at a later stage, perhaps in a final round-up of technical issues. As we mentioned at the outset, I think IFSA's main concern is that the bill is passed as swiftly as possible, and we would not want an issue such as this one to delay passage.²¹

Committee view

3.22 The committee notes that there are a limited number of bona fide cases where individuals wishing to transfer their overseas-accumulated superannuation benefits into Australia will breach the non-concessional contributions cap of \$450 000.²² In these circumstances, such individuals will be subject to the top marginal tax rate on any amount exceeding the cap. The committee also notes the transitional arrangements that will allow individuals in such circumstances until 30 June 2007 to make a transfer of up to \$1 million from overseas superannuation benefits.

3.23 The committee is of the view that it is preferable to encourage these individuals to transfer their superannuation benefits to Australia rather than for them to remain overseas.

19 Mr Trevor Thomas, Principal Adviser, Superannuation, Retirement and Savings Division, Department of the Treasury, *Committee Hansard*, 30 January 2007, p. 52.

20 Mr Trevor Thomas, Principal Adviser, Superannuation, Retirement and Savings Division, Department of the Treasury, *Committee Hansard*, 30 January 2007, p. 52.

21 Miss Stephanie Lee, Senior Policy Manager, Investment and Financial Services Association, *Committee Hansard*, 30 January 2007, p. 13.

22 Assuming that there will be a single transfer of funds which would allow the individual to take advantage of the three-year non-concessional contributions limit of \$450 000.

3.24 However, given the complexities of devising a comprehensive and robust anti-avoidance mechanism and the delay this will cause to the passage of the bill, the committee urges the government to further consider this issue once the bill is enacted.

Recommendation 1

3.25 The committee recommends that the government consult with the superannuation industry regarding the development of anti-avoidance mechanisms that will allow bona fide overseas transfers of superannuation benefits in excess of the non-concessional contribution cap, at an appropriate time after the bill is enacted.

Timing of excess contributions tax debts

3.26 Concerns were raised by a number of submitters regarding the proposed timeframes for the payment of tax liabilities arising from 'excess' contributions.²³ Under the new arrangements, if the contributions caps were exceeded, an individual will accrue a tax liability. The individual may (for excess concessional contributions) or must (for excess non-concessional contributions) withdraw an amount equal to their tax liability from their superannuation account. An individual will be able to access their superannuation savings, which is generally restricted under preservation age rules, by providing a 'release authority' to their superannuation fund.

3.27 Excess contributions tax will be due within 21 days after the ATO gives the individual notice of the assessment.²⁴ Several submitters explained however that this period will often be exceeded given the longer timeframes proposed for providing the release authority to the superannuation provider (21 days for non-concessional contributions or 90 days for concessional contributions) and actioning the release authority (30 days).²⁵ It was argued this will result in individuals failing to pay their contributions tax debt within the prescribed 21 day period and consequently incurring a general interest charge (GIC) for late payment.²⁶

3.28 The Association of Superannuation Funds of Australia explained that the proposed timeframes will apply pressure on superannuation funds:

...without some adjustments to the timeframes, individual taxpayers seeking to do the right thing by paying their tax as quickly as possible could be

23 See for example Association of Superannuation Funds of Australia, *Submission 6*, pp 3–5; National Institute of Accountants, *Submission 13*, p. 2; Mercer Human Resource Consulting, *Submission 16*, p. 29; and Investment & Financial Services Association, *Submission 18*, p. 5.

24 New section 292-385. This timeframe is consistent with the arrangements applying to an individual's other income tax liabilities.

25 New sections 292-410 and 292-415.

26 See for example Association of Superannuation Funds of Australia, *Submission 6*, pp 3–5; National Institute of Accountants, *Submission 13*, p. 2; Mercer Human Resource Consulting, *Submission 16*, p. 29; and Investment & Financial Services Association, *Submission 18*, p. 5. The relevant provision is new section 292-390.

subject to additional penalties because a fund took the full 30-day period to process a request. Though we recognise that the tax is intended as a penalty tax, this approach is unfair on both individual taxpayers and funds. As the individual has been given the opportunity to authorize a superannuation fund to pay the tax liability, sufficient time should be allowed for the fund to meet that obligation without the individual incurring GIC for late payment. Should the 21 day time period for payment not be extended beyond the 30 days allowed for the fund to process the payment request it will create unnecessary problems for funds as they are blamed for any [GIC] and become or be subject to pressure to process authorities more quickly than the 30 days.²⁷

3.29 ASFA submitted that the proposed timeframes will result in the creation of a 'constant circle of small GIC bills, late payment by funds followed by further GIC.'²⁸

3.30 ASFA and the Investment & Financial Services Association (IFSA) recommended that the period for the payment of excess contributions tax liabilities to be extended to 45 days and around 50–60 days, respectively.

Committee view

3.31 The committee notes the seemingly inconsistent timeframes between the imposition of the GIC (21 days) and those allowing an individual to access their superannuation funds (21 or 90 days for providing the release authority and 30 day for the superannuation provider to act). However, the committee also notes that an individual could avoid the GIC by initially paying the tax liability within the 21 day period from other income sources and then be reimbursed from his or her superannuation savings once the release authority was processed by the superannuation fund. The committee further notes that the Commissioner has the discretion in special circumstances to disregard or reallocate contributions where it would be 'unjust, unreasonable or inappropriate to impose the liability for excess contributions tax.'²⁹ In these circumstances the committee considers that changing the proposed timing of excess contributions tax debts is unwarranted.

Deductibility of superannuation contributions

3.32 CPA Australia and the Institute of Chartered Accountants in Australia proposed the abolition of the '10 per cent deductibility rule' that limits those who are able to claim a tax deduction for personal superannuation contributions to individuals who have employment income of less than 10 per cent of their assessable income (plus reportable fringe benefits). CPA Australia argued that:

27 Association of Superannuation Funds of Australia, *Submission 6*, p. 4.

28 Association of Superannuation Funds of Australia, *Submission 6*, p. 4.

29 Explanatory Memorandum, p. 34.

...with full deductibility being given to personal contributions, there is now essentially no difference between the treatment of employer, salary sacrifice and personal deductible (i.e. self employed) contributions and therefore no rationale as to why such deductibility is not permitted.³⁰

3.33 The Institute of Chartered Accountants in Australia agreed that the bill will introduce an artificial distinction between different sources of income and recommended 'that the restriction be removed altogether, allowing all Australians to make their maximum deductible contribution regardless of how income is earned.'³¹

3.34 CPA Australia explained the rationale for its proposal:

Abolishing the '10% rule' would create a level playing field whereby all superannuants would have the same access to concessional contributions and the same flexibility to decide whether their voluntary contributions should be made from before or after tax income. The limits on concessional and [non-concessional] contributions would ensure everyone receives the same concessions. Such a move would be another important step in ensuring equity and simplifying the superannuation system.³²

3.35 Both organisations noted that if the 10 per cent rule is abolished the proposed concessional contributions cap of \$50 000 will control the concession available.

Committee view

3.36 The committee notes that those employees who do not qualify for the 10 per cent rule deduction and whose employer does not offer or limit their salary sacrificing arrangements may not be able to fully utilise the \$50 000 concessional contributions deduction. However, the committee also notes that these individuals will still have access to the non-concessional contributions cap of \$150 000 annually. The committee further notes that abolishing the 10 per cent rule may have significant fiscal implications for the superannuation package.

3.37 The committee considers that the package as it stands is generous and strikes the right balance to encourage greater saving for retirement and prolonged workforce participation. Consequently, the committee does not consider that any changes to the deductibility arrangements for superannuation contributions are warranted.

Payments to former employees

3.38 Several submitters raised concerns regarding the proposed treatment of contributions for former employees. New section 290-85 will allow employers to claim a deduction for contributions made on behalf of former employees in two circumstances – in order to meet a superannuation guarantee obligation and as a

30 CPA Australia, *Submission 17*, p. 4.

31 Institute of Chartered Accountants in Australia, *Submission 20*, p. 1.

32 CPA Australia, *Submission 17*, p. 4.

one-off salary sacrifice payment.³³ The National Institute of Accountants and Mercer Human Resource Consulting identified two further circumstances where they considered the deduction ought to apply.³⁴

3.39 Firstly, in circumstances where an employee who makes salary sacrifice superannuation contributions leaves at short notice and two regular employer payments are made following their departure – one for the previous pay period and another for the current period. The current drafting appears to permit a deduction for the first payment but not the second (as it permits only a one-off payment).

3.40 The other circumstance identified by submitters was where an employer makes voluntary superannuation contributions above the level of the superannuation guarantee. Any contributions of this nature, properly made on behalf of the former employee after their departure, will fall outside the scope of new section 290-85 and therefore the employer will not be able to claim a deduction for such contributions.

3.41 The National Institute of Accountants canvassed two broad options to permit deductions for such contributions without opening the system up to abuse – a limit of three payments and a limited period of three months to finalise payments.³⁵

Committee view

3.42 The committee is concerned about the adverse impact this provision may have on employers seeking to provide legitimate superannuation payments to their former employees. The committee is of the view that an employer ought to be able to claim a deduction for contributions when they are legitimately made on behalf of a former employee and the contributions relate to a period of service during which the person was an employee. The committee considers that limits ought to be set in order to prevent claims that do not relate to the employee services provided.

Recommendation 2

3.43 The committee recommends that the government consider introducing an amendment to new section 290-85 be amended to allow employers to claim a deduction for contributions when they are legitimately made on behalf of a former employee and the contributions relate to a period of service during which the person was an employee. The Treasury should consult with the superannuation industry to determine suitable limits.

33 New paragraphs 290-85(1)(a) and (b) respectively.

34 National Institute of Accountants, *Submission 13*, p. 2; and Mercer Human Resource Consulting, *Submission 16*, pp 24–25.

35 National Institute of Accountants, *Submission 13*, p. 2. Mercer Human Resource Consulting also flagged the possibility of a limitation on the period to finalise payments: *Submission 16*, p. 25.

Trustee contributions

3.44 AXA Australia questioned why the ability for trustees to make contributions on behalf of members without being subject to contributions tax had been omitted from the bill whereas it exists in the current legislation.³⁶ Although AXA acknowledged that this provision is not frequently used, it outlined several circumstances under which a trustee may need to make a contribution on behalf of a member:

For example, if a Trustee has received an amount of compensation or had legal costs awarded these amounts may need to be paid into the fund as a trustee contribution so that they can be distributed as earnings. Similarly, a trustee contribution may arise where a refund of fee is provided by a service provider in respect of a previous period to correct a billing error.³⁷

3.45 In response to a question on notice the Association of Superannuation Funds of Australia also supported in the inclusion of the current arrangements in within the new regime.³⁸

Committee view

3.46 The committee is of the view that contributions made by a trustee of a superannuation fund should continue to be excluded from a fund's assessable income.

Recommendation 3

3.47 The committee recommends that the current provisions exempting trustee contributions from contributions tax should be reproduced in the bill.

Taxation of superannuation benefits

3.48 The changes proposed by the bill regarding the removal of tax on superannuation benefits for individuals aged 60 and over were generally well received. However a number of issues were raised which are discussed below including:

- Treatment of benefits from untaxed funds
- Calculating the tax exempt benefit component
- Taxes on death benefits
- Treatment of the tax free component of existing pension payments

36 AXA Australia, *Submission 12*, p. 2, referring to sub-subparagraph 274(1)(a)(i)(B) of the *Income Taxation Assessment Act 1936*.

37 AXA Australia, *Submission 12*, p. 2.

38 Association of Superannuation Funds of Australia, answer to question on notice, 30 January 2007 (received 31 January 2007).

Treatment of benefits from untaxed funds

3.49 Superannuation schemes with untaxed components have not been subjected to tax on contributions and earnings, as opposed to the more common taxed funds. Benefits that have an untaxed element (typically payments from an untaxed fund) will still be subject to tax. Untaxed funds are generally a component of public sector defined benefit funds. The amount of tax applied to untaxed earnings is explained at page 47 of the Explanatory Memorandum.

3.50 Although this category of benefits will continue to be taxed, the arrangements proposed are more generous than those currently in place for those who receive a lump sum in excess of the current low rate threshold.³⁹ In addition, untaxed benefits received as an income stream by those 60 and over will be entitled to a 10 per cent tax offset not currently applied.

3.51 To ensure equitable tax treatment the proposals provide for untaxed components of superannuation benefits to continue to be subject to benefits tax, albeit often at a lower rate than currently applies to such benefits. This distinction generally applies to members of public sector defined benefit schemes. A number of contributors, many from people associated with the Australian Defence Forces (ADF), objected to these arrangements.

De facto RBLs on untaxed benefits

3.52 Although supporting the principle that benefits from untaxed schemes should be subject to a tax on end benefits, CPA Australia commented that applying the top marginal tax rate for large lump sums is inequitable:

...the proposal to tax at the top marginal tax rate that part of the post-June 1983 untaxed element above the threshold of \$1 million is no longer fair or equitable. There remains, in effect, a de facto RBL for members of unfunded schemes...[which is something] their counterparts in taxed funds no longer have to contend with.⁴⁰

3.53 CPA Australia also criticised what they saw as the inconsistent treatment of superannuation income streams:

...pension income paid from an untaxed scheme will be assessable income (albeit with a modest rebate) while pension income from a taxed fund will not be assessed. The result may well be the recipient of an untaxed pension being pushed into a higher tax bracket and being further disadvantaged compared to [sic] their taxed fund equivalent.⁴¹

39 Explanatory Memorandum, p. 51. Lump sums above this threshold (\$135, 590 in 2006-07) are taxed at 30 per cent and at marginal rates above the RBL.

40 CPA Australia, *Submission 17*, p. 3.

41 CPA Australia, *Submission 17*, p. 4.

3.54 CPA Australia argued that the proposals did not match their intention of maintaining parity between members of the two types of schemes:

We believe that if significant benefits, such as removal of the RBLs and abolition of benefits tax over age 60, are being provided to members of taxed funds, equivalent benefits should also be provided to members of unfunded schemes. Parity should be maintained so that the only difference between taxed funds and untaxed schemes is a tax on benefit to compensate for the taxes foregone on contributions and earnings. The current differential between the two is generally 15%, and we believe this should be maintained going forward.⁴²

Committee view

3.55 The committee notes CPA Australia's complaint that the \$1 million threshold applying to concessional tax treatment on any untaxed superannuation benefits represents the maintenance of a de facto RBL for members of untaxed funds. The committee does not reject CPA Australia's assertion that this provision reflects inequitable treatment of benefits between members of taxed and untaxed schemes. However, members of untaxed schemes are not subject to the usual contributions limits (as a proportion of their benefit is only funded on withdrawal); therefore the committee is satisfied that applying this relatively high threshold is reasonable to ensure overall equity between members of the two types of schemes.

Tax on additional assessable income

3.56 The committee has also been alerted to possible inequities associated with members of taxed and untaxed schemes who receive assessable income in addition to their superannuation benefits. In relation to members of untaxed schemes, Mr Neville Smith submitted:

The proposed changes result in a further inequity for many individuals who have other sources of income or receive higher superannuation pensions. It taxes the residual end benefits tax at marginal rates, rather than subjecting it to a separate 15% flat tax.⁴³

3.57 For members of taxed schemes receiving a superannuation income stream, additional income is taxed at a marginal rate from a starting point of zero. This category of recipient is therefore able to take advantage of the tax free threshold and the overall progressiveness of the income tax system when tax is calculated on their additional income. However, pension recipients from untaxed funds are taxed at marginal rates (albeit with a 10 per cent offset for those 60 and over). Additional income earned by these fund members is combined with their superannuation income stream to determine their assessable income. Consequently, more tax is paid on this

42 CPA Australia, *Submission 17*, p. 4.

43 Neville Smith, *Submission 2*, p. 6.

additional income by those in untaxed schemes than those receiving a benefit from a taxed scheme.

Committee view

3.58 The committee considers this to be an anomaly that applies inequitable tax treatment to the same type of assessable income, determined only by the nature of the fund from which a person's benefits are received. The committee is of the view that the government should reconsider the way in which total taxable income is classified for those in untaxed schemes. Instead of combining both a superannuation income stream and additional income to produce a total assessable income, the two types of income should be assessed separately. This would enable additional income received by all superannuation income stream recipients to be assessed for tax purposes from a starting point of zero.

Recommendation 4

3.59 The government should consider separately assessing, for taxation purposes, superannuation income streams and additional assessable income.

Military service schemes

3.60 Other submitters, particularly those associated with the Defence Force Retirement Benefits (DFRB) and Defence Force Retirement and Death Benefits (DFRDB) superannuation schemes, complained that the tax advantages of being in an untaxed scheme had been misinterpreted. Many quoted a letter of explanation from the Treasurer, the Hon. Peter Costello MP, in pursuing this argument. It was apparently circulated through the veterans' community and stated:

Benefits paid from an untaxed source would still be taxed under the Government's plan. To remove the tax on these benefits would mean members of these funds would pay no tax on this part of their superannuation. This would be an unfair advantage to members of those funds as they have not paid the contributions and earnings tax that 90 per cent of Australians have paid on their benefits.⁴⁴

3.61 These submitters contended that taxed schemes had not always been so, thus the requirement for imposing equity through a compensatory benefits tax on untaxed funds had been overestimated. For example, Mr Michael Gill wrote:

...taxation on contributions to and investment earnings of superannuation funds did not start until 1988. Consequently, any advantage to pre-1988 DFRDB members, such as me, as foreshadowed by the Treasurer, in his letter cited above, is imaginary. We were, in fact, disadvantaged by the compulsion to join DFRB then DFRDB when we could have been in private superannuation schemes, which were earning strong returns on

44 Correspondence to the Hon. Phil Ruddock MP dated 14 July 2006. Cited in Ms Patricia Graham, *Submission 9*, p. 3.

funds invested, while our contributions were applied for the benefit of the wider community, interest free, through ongoing government programmes.⁴⁵

3.62 Mr John Graham also denied the tax advantage referred to by the Treasurer:

Taxation on these elements was only introduced ‘post 1988’. From 1948 to 1988, both Public and Private sector funds, for taxation purposes, were treated in exactly the same manner. Even though there was no DFRB fund post 1972, effectively, those who were discharged up to the date of introduction of those taxes do not come into [the] definition that all Public Sector superannuants had an ‘advantage’.

Indeed the Private Sector funds had the advantage of their funds being invested, tax free, up to 1988, whilst the Public sector funds were applied to the Governments spending plans...⁴⁶

3.63 From a slightly different perspective, Mr Neville Smith claimed that rather than being an advantage to fund members, the untaxed status of public sector schemes was used by government to defer salary costs:

...the superannuation entitlement was a fundamental element of the otherwise under-priced salary packages provided by governments prior to their recent adoption of mega salary packages. And governments of all political persuasions relied on this as part of their recruitment and retention arrangements.⁴⁷

3.64 Other submitters emphasised the often involuntary nature of early retirement from the defence forces. For instance, the Regular Defence Force Welfare Association (RDFWA) indicated that the package did not accommodate for the unique nature of military service, particularly the compulsory termination of service for most ADF members at 55, the risk of compulsory termination on the basis of medical disability and the inherent risks associated with ADF service.⁴⁸

3.65 Mr Colin Wade submitted:

The proposed superannuation plan fails to distinguish between “normal” retirement pension payments and “involuntary”, medical discharge invalidity pension payments to members in the military superannuation schemes. While the Government initiatives have dramatically improved the awareness of the importance of saving early for retirement, members in receipt of invalidity pension payments from the military superannuation schemes cannot benefit from the Government’s initiatives and incentives to improve their retirement. As a result, the living standard of retirees relying

45 Mr Michael Gill, *Submission 1*, p. 2.

46 Mr John Graham, *Submission 5*, p. 1.

47 Mr Neville Smith, *Submission 2*, p. 2.

48 Regular Defence Force Welfare Association, *Submission 4*, pp. 1–2.

on the invalidity pension payment from military superannuation schemes cannot keep pace with those of the general community.⁴⁹

3.66 In evidence to the committee, the RDFWA sought to extend tax free treatment to those who do not have the opportunity to benefit from the incentives included in this package:

...if this committee can make no other changes to this legislation, the RDFWA would ask that tax-free status be extended to all recipients of military class A invalidity pensions—that is those who are unable ever to work again—irrespective of their age, rather than making them wait until they turn 60.⁵⁰

3.67 Treasury stated that veterans would not be paying more tax under the proposed new regime. Officers from the department indicated that for those aged 60 and over in untaxed schemes, including military schemes, the tax savings are as follows:

If they are receiving a lump sum, the tax is reduced by 15 percentage points. If they are receiving a pension, they receive the 10 per cent tax offset. That applies irrespective of when the pension commences; it does not have to commence from the commencement of the simplified superannuation regime on 1 July [2007]. It also applies to all existing pensions. So certainly members of those schemes would be eligible for that 10 per cent tax offset and that should lead to a reduction in their tax.⁵¹

3.68 The committee was told that the intent of the package was to address differences between whole, broad categories of fund members:

The focus of the government's attention in this particular package is a broad one, looking at the way the system as a whole operates. The government had particular regard to the different circumstances of taxed schemes versus untaxed schemes and looked at the particular arrangements that were necessary in each of those broad groups. But, in terms of the design of particular schemes, that is something which has not clearly been within the purview of this package of arrangements that the government is heading into.⁵²

3.69 Treasury indicated that, rather than addressing financial difficulties for veterans by altering tax treatment, a more appropriate way of dealing with these problems would be to 'think about the scheme design for these particular circumstances for defence personnel'.⁵³ Treasury officials told the committee that any

49 Mr Colin Wade, *Submission 8*, p. 2.

50 *Committee Hansard*, 30 January 2007, p. 24.

51 *Committee Hansard*, 30 January 2007, p. 50.

52 *Committee Hansard*, 30 January 2007, pp. 50-51.

53 *Committee Hansard*, 30 January 2007, p. 52.

rectification of military scheme deficiencies 'is an issue for the military. It is essentially the responsibility of the Minister for Veterans' Affairs'.⁵⁴

Committee view

3.70 The committee recognises the unique circumstances in which veterans find themselves. Military personnel rarely have the opportunity to work until the usual age of retirement, especially given the inherent physical risks associated with serving in the ADF. Further, as a consequence of military service many former ADF members are left incapable of undertaking further employment.

3.71 Although the committee is sympathetic to the financial circumstances of veterans, particularly those unable to work, an assessment needs to be made as to whether the tax system is the most appropriate way of dealing with these cases of hardship. This is particularly salient when examining a proposal with the principal aim of simplifying existing taxation arrangements. The committee notes assurances provided by Treasury that no member of an untaxed superannuation scheme, including veterans, will be subject to higher taxes as a consequence of this package should it be passed by the parliament. If veterans have been placed at a relative financial disadvantage due to the inadequacy of their military superannuation funds, the committee is of the opinion that redress should not occur through special tax exemptions. To do so would negate the purpose of the legislation and potentially create inequitable treatment between people facing the same hardship via different circumstances.

3.72 Accordingly, the committee is not persuaded that the tax free treatment on benefits should be further extended. However, the committee strongly encourages the government to examine the adequacy of financial protection that military superannuation schemes provide for incapacitated ADF members, particularly in comparison with other public sector superannuation schemes.

Calculating the tax exempt benefit component

3.73 In assessing the tax on benefits for those aged under 60, the varying benefit components presently operating are to be simplified into two components: exempt (tax free) and taxable. The exempt component will be comprised of the value of non-concessional contributions and a crystallised segment, primarily consisting of benefits accrued before 1 July 1983.⁵⁵

3.74 The Explanatory Memorandum explains:

For most superannuation interests, a pre-July 1983 amount will be calculated as at 30 June 2007 using the existing legislative formula. This

54 Mr Trevor Thomas, *Committee Hansard*, 30 January 2007, p. 51.

55 It also includes a capital gains exempt component, concessional component and post-June 1994 invalidity component.

amount will become a fixed amount and form part of the tax free component. ...

Superannuation providers will have until 30 June 2008 to calculate the crystallised pre-July 1983 segment. Superannuation providers that do not calculate this amount by this date for all affected superannuation interests, are subject to an administrative penalty of 5 penalty units. ...

As outlined above, the tax free component of superannuation income streams in existence as at 1 July 2007 will be calculated based on the current 'deductible amount' concept. A pre-July 1983 amount is therefore not calculated until a trigger event occurs to move the superannuation income stream into the new arrangements.

Separate arrangements apply to superannuation benefits that have not been subject to contributions or earnings tax within the fund. This reflects existing arrangements. The pre-July 1983 segment for an element untaxed in the fund is only calculated when a lump sum superannuation benefit is withdrawn from a superannuation plan or rolled over into a taxed superannuation scheme.⁵⁶

3.75 Some organisations questioned the rationale for requiring the crystallisation to be calculated by 30 June 2008. AXA Australia wrote:

The pre July 1983 component is only relevant at the time that a member is paid a benefit, or seeks an estimate of the taxation components of their benefit in contemplation of the payment of a benefit. This information is not regularly reported to the member or the Australian Tax Office except upon payment, and is not used for any other purpose.⁵⁷

3.76 Citing the absence of a need for the calculation until a trigger event, along with the administrative burden associated with obtaining the necessary information from members, AXA Australia claimed that the proposal in its current form 'unnecessarily increases the workload of superannuation trustees, it inconveniences members; and it unfairly exposes trustees to administrative penalties'.⁵⁸

3.77 IFSA also recommended a more flexible approach to the date at which this task should be undertaken, while retaining the condition that the pre-1983 value be crystallised as at 30 June 2007:

...the information required to perform these calculations is either paper based or held on imaging systems and will need to be retrieved and calculated manually. As such a number of superannuation providers only calculate the components upon enquiry or benefit payment.

IFSA proposes that closed superannuation funds (closed as of 1 July 2006) be given the flexibility to crystallise the pre-'83 component at a later point

56 Explanatory Memorandum, p. 76.

57 AXA Australia, *Submission 12*, p. 6.

58 AXA Australia, *Submission 12*, p. 6.

in time, when a certain event is triggered (but still using the value as at 30 June 2007). For example, when the member exits the fund or enquires as to the breakdown of the tax components. Currently, closed superannuation funds calculate (many on a manual basis) the relevant components when such events are triggered. Closed superannuation funds would like to retain the status quo. We do not believe that this will compromise the intent of the legislation.⁵⁹

3.78 Failing this, IFSA suggested that funds be given three years, rather than one, to crystallise the pre-1983 tax free component of balances.

3.79 Mercer raised the different treatment afforded to taxed and untaxed funds in this regard:

...this aspect...would appear to result in many anomalies and difficulties for those funds. We can envisage situations where some members may lose all entitlement to a pre-July 1983 component (where a fund changes its policy and begins paying benefits in taxed form). Conversely, it appears that where a benefit that has previously been considered to be taxed (with a crystallised pre-July 1983 component), is later paid in untaxed form, then a further pre-July 1983 component is determined resulting in an overstatement of the pre-July 1983 component.

We therefore recommend that pre-July 1983 components are crystallised as at 1 July 2007 for members of untaxed schemes as well as for members of taxed schemes.⁶⁰

3.80 ASFA commented that the proposals provide an incentive to maximise pre-July 1983 components by amalgamating separate superannuation accounts with varying eligible service period (ESP) starting dates. They warned, however, inequities could occur as a result of varying individual circumstances:

...amalgamation from different funds prior to the 30 June 2007 deadline will be difficult and in some instances impossible for certain individuals, as a result of either restrictive fund rules or prohibitive exit fees.⁶¹

3.81 ASFA suggested:

Denying the earlier ESP starting date and the resulting inequity between individuals in different circumstances could be avoided if the funds were permitted to adjust a member's ESP starting date based upon written evidence of an earlier starting date from another complying superannuation fund. Members should be able to provide data to the fund no later than 30 June 2007, being the date by which they would otherwise have had to amalgamate their accounts in order to achieve the same result.⁶²

59 Investment & Financial Services Association, *Submission 18*, p. 4.

60 Mercer Human Resource Consulting, *Submission 16*, p. 27.

61 Association of Superannuation Funds of Australia, *Submission 6*, p. 5.

62 ASFA, *Submission 6*, p. 5.

3.82 Mercer has also sought clarification on the calculation of the post-June 1994 invalidity component of the crystallised segment. According to Mercer the bill 'requires trustees to crystallise an invalidity component as at 1 July 2007 for those members who have left their benefit in the fund'.⁶³ However, Mercer claimed that the EM contradicts this interpretation when it states:

...a post-June 1994 invalidity component would only exist if such a component had been rolled into a superannuation interest prior to 1 July 2007.⁶⁴

Committee view

3.83 The committee recognises that the requirement to crystallise the tax exempt component applying to benefits paid to those under 60 places an extra administrative burden on superannuation funds. However, complying with the need to undertake this calculation by 30 June 2008 does not seem to be an unreasonable expectation. Allowing an open ended time frame for the completion of this task would hinder the intent of simplifying the currently complex tax exempt component. The committee therefore sees no need to amend this aspect of the bill.

Taxes on death benefits

3.84 The committee received a number of submissions expressing concern over the discrepancy between the tax treatment of benefits withdrawn before death and those that are not. Most of these warned of 'death bed withdrawals',⁶⁵ whereby those 60 and over who have the opportunity to do so would cash in their superannuation benefit before they died to ensure their beneficiaries received the money tax free. For the beneficiaries of those who died suddenly or did not have access to good financial advice, the benefit would be subject to tax under the circumstances outlined above. For example, non-dependant children caught out in this instance would have their benefit taxed at 15 per cent.⁶⁶

3.85 CPA Australia outlined the inequities this could create:

...an individual knowing they are going to die will be able to take their superannuation benefit as a lump sum and pass it on to their adult children tax-free. On the other hand, where death is sudden and unforeseen, the benefit may still be paid to the adult children but it would be taxed at 15%. Additionally, re-contribution strategies are already being promoted in the market to withdraw the taxable component over time and re-contribute it as

63 Mercer Human Resource Consulting, *Submission 16*, p. 17.

64 Explanatory Memorandum, p. 70.

65 See for example Superannuation Australia, *Submission 19*, p. 2.

66 Or 30 per cent on untaxed components.

an undeducted contribution, effectively reducing the taxable component to nil.⁶⁷

3.86 Mercer also suggested that disputes with the ATO could arise:

...timing is critical. A benefit which is not subject to any tax if paid to the member can become subject to tax if payment is deferred until after death. The anomalies are obvious. Furthermore, superannuation funds, through no fault of their own, are likely to be caught up in taxation disputes at the time of death benefit payments.

3.87 Most submitters that raised this issue also recommended that superannuation death benefits be made tax free.⁶⁸

3.88 Concerns were also raised over the proposal to prevent non-dependants from receiving a reversionary superannuation income stream on the death of the pension recipient. Instead, death benefit payments to non-dependants will have to be made as a lump sum.⁶⁹ Pitcher Partners contended that this unfairly affected those who held existing pensions with agreed terms naming a non-dependant as a reversionary. It suggested restitution for beneficiaries in this position:

If it is the intention to stop pensions reverting beyond the members spouse or infant child, it seems extraordinarily unfair and unreasonable to impose this change on existing pensions without providing some relief or remedy. In our view, the following options should be considered:

- Allow a grandfathering of existing reversionary arrangements that were in place, say, on the day that legislation was tabled in Parliament. This will alleviate the difficulties discussed above while still largely preserving the Government's objectives.
- The Government should allow existing pensioners adversely impacted by this change to be able to choose to amend their arrangements in a way that is consistent with the removal of the reversionary option caused by the legislation. The pensioners should, however, be allowed to continue with their existing style of pension if they wished.
- The Government should consider allowing commutation of existing noncommutable pensions that are adversely impacted by this proposed change. The commutation should allow members to effectively "start again" in deciding the benefit option that best suits them.⁷⁰

67 CPA Australia, *Submission 17*, p. 2.

68 See for example, Mercer Human Resource Consulting, *Submission 16*, p. 16; CPA Australia, *Submission 17*, p. 2; Institute of Chartered Accountants in Australia, *Submission 20*, pp 2–3; Australian Institute of Superannuation Trustees, correspondence received 19 January 2007, p. 5; Taxation Institute of Australia, correspondence received 22 January 2007, p. 5.

69 Department of Treasury, *A Plan to Simplify and Streamline Superannuation*, May 2006, p. 16.

70 Pitcher Partners, correspondence received 24 January 2007, p. 4.

3.89 The committee was also informed of inconsistencies in the definition of 'dependants' within different acts. According to the Taxation Institute of Australia:

...there are existing anomalies between the definition of "dependant" in the Income Tax Assessment Act 1936 (ITAA 1936) and the Superannuation Industry Supervision Act 1993 (SIS Act) that can already result in inequitable taxing results.

The definition of "dependant" in ITAA 1936 only includes a child up to the age of 18 (s27A(1)), but under the SIS Act, can include any child of the person (s 10(1)), with the result that a superannuation benefit can be paid to an adult child as a dependant under the SIS Act but then the same person is taxed as if the benefit was paid to a non-dependant under the ITAA 1936.

In terms of addressing this problem within the context of the bill in question, the Taxation Institute believes that there should be no difference in the application of rules according to whether the recipient is a dependant or non-dependant. It is recommended that all death benefits should be able to be paid tax-free from 1 July 2007.⁷¹

3.90 The RDFWA recommended that benefits be tax free for the families of deceased defence personnel whose benefactor died while a serving member of the ADF or from causes related to their service.⁷²

Committee view

3.91 The committee notes that the tax treatment of lump sum superannuation death benefits for both dependants and non-dependants will, with the exception of the removal of the application of RBLs, remain the same if this bill is passed.⁷³ The present distinction between the two categories of beneficiaries would remain: lump sums paid to dependants would continue to be tax free and non-dependants would be subject to 15 per cent tax (or 30 per cent for any untaxed element in the fund).

3.92 The committee recognises that the removal of benefits tax for those aged 60 and over may lead some recipients to restructure their affairs to ensure their non-dependant children ultimately pay no tax on those monies at death. However, it was not the intention of this package to make superannuation death benefits newly tax free for non-dependents, a measure that would carry obvious fiscal implications. Therefore the committee does not support extending the tax free status on such benefits, currently available to dependants, to non-dependants.

71 Taxation Institute of Australia, correspondence received 22 January 2007, p. 5. See also CPA Australia, *Submission 17*, p. 2.

72 Regular Defence Force Welfare Association, *Submission 4*, p. 2.

73 Non-dependants will no longer be able to receive superannuation death benefits as an income stream.

Treatment of tax free component of existing pension payments

3.93 The proposed proportioning rule would simplify the calculation of the tax free and taxable components of a superannuation lump sum or income stream, paid out after 1 July 2007. AXA Australia argued that the wording of proposed new paragraph 307-125(3)(c) of the *Income Tax (Transitional Provisions) Act 1997*, which refers to 'the holder of the superannuation interest turns 60...after 30 June 2007' and which would make the relevant interest subject to the new proportioning arrangements, appears to preclude existing pensioners who have already turned 60.⁷⁴ AXA stated that:

The consequence of this appears to be that existing pensioners who have already turned 60 will continue to have all the 'old' taxation components stored and maintained...⁷⁵

3.94 AXA submitted that existing pensioners who have turned 60 prior to 1 July 2007 should be subject to the new proportioning arrangements from that date as:

This will have no consequence for the pensioner or their dependants but will simplify the administration of their pension as there will no longer be an obligation on the pension provider to maintain all of the existing tax components. The pension provider will, instead, be able to administer the pension under the new proportioning arrangements, providing administrative efficiencies and reducing compliance costs.⁷⁶

3.95 AXA suggested that an appropriate alternative wording would be 'the holder of superannuation interest turns or has already attained age 60.'⁷⁷

Committee view

3.96 As there appears to be no financial implication for pensioners already over 60 and as it would simplify the administration for superannuation providers, the committee supports AXA's proposed wording change.

Recommendation 5

3.97 The committee recommends that the government consider introducing amendments to the new paragraph 307-125(3)(c) of the *Income Tax (Transitional Provisions) Act 1997* so that it applies to the holder of the superannuation interest who turns, or who has already turned, 60.

74 New paragraph 307-125(3)(c) of the *Income Tax (Transitional Provisions) Act 1997*.

75 AXA Australia, *Submission 12*, p. 4.

76 AXA Australia, *Submission 12*, p. 4.

77 AXA Australia, *Submission 12*, p. 5.

Tax File Number issues

3.98 The use of Tax File Numbers (TFNs) is an integral part ensuring the effectiveness of the proposed contributions caps. Although there was general support for the use of TFNs proposed in the bill, there were a number of issues of genuine concern raised by submitters. Mercer responded most strongly to the implications posed by the TFN arrangements contained in the bill:

In our view the no-TFN issues are extremely serious and have the potential of turning the introduction of the new system into a significant problem for funds, many members and the community's perception of superannuation. However we recognise the fundamental importance of contribution caps in the new system and the requirement to use TFNs. The issues need to be confronted now and a more appropriate solution developed.⁷⁸

3.99 The following issues were raised by submitters and are discussed below:

- Collection of TFNs
- Imposition of no-TFN tax on superannuation funds
- Deadline for providing TFNs

Collection of TFNs

3.100 Several submitters expressed concerns over what IFSA described as a 'robust regime for the collection of TFNs'⁷⁹ that will be required to ensure individuals are not subjected to the top marginal tax rate on contributions for failing to provide their TFNs, and in order for the contribution cap arrangements to work efficiently and effectively.

3.101 In its submission Mercer explained its concerns for the workability of the new system resulting from the no-TFN clauses:

- Identifying and either refusing to accept or refunding non-concessional contributions will be a costly administrative challenge. Amendments to administration systems will need to be in place from 1 July 2007...;
- New systems will also need to be in place by 1 July 2007 to deduct the no-TFN tax when any benefits are paid. Whilst the tax does not have to be paid until at least 30 June 2008, funds will need to ensure that the appropriate amount has been withheld from the benefit of any exiting member;
- The process for recovering any no-TFN tax is cumbersome and slow;
- It is likely that many members will never recoup the no-TFN tax paid.⁸⁰

78 Mercer Human Resource Consulting, *Submission 16*, p. 10.

79 Investment & Financial Services Association, *Submission 18*, p. 4.

80 Mercer Human Resource Consulting, *Submission 16*, p. 5.

3.102 In Mercer's view these effects are looming large as some major funds currently have more than half of their members that have not supplied a TFN and past approaches to collect TFNs have had limited success.⁸¹ The Australian Institute of Superannuation Trustees pointed out that some superannuation funds have non-quotation rates as high as 60–70 per cent.⁸²

3.103 Despite these high figures for individual funds, the committee heard evidence that suggests that the overall non-quotation level is much lower. Ms Vivian of the Australian Taxation Office (ATO) told the committee that the ATO:

...can match up to about 93 per cent. That leaves approximately four million active member contribution accounts without a TFN...

About 3.2 million of the four million come in without a tax file number that we can match, which leaves about 800,000 [that the ATO is currently unable to match].⁸³

3.104 Ms Vivian went on to explain how the ATO intends to reduce the non-quotation of TFNs:

In the [public education] campaign, we [the ATO] will be writing to those 3.2 million people. Assuming that they do not object, our aim is to provide their tax file number directly to the fund. That leaves us with about 800,000 accounts [without TFNs]. The interesting thing is that about 50 per cent of those member contribution statements relate to about 12 funds. So our aim is to work closely with those 12 funds to see if we can unpack the data a bit more and get a better match.⁸⁴

3.105 Treasury officials acknowledged that there will always be some degree of non-TFN quotation: '[t]here will always be people who will not quote their TFN for privacy reasons or for other reasons.'⁸⁵

3.106 To protect individuals who make annual contributions of \$1000 or less the bill provides exemption from the no-TFN tax. Treasury officials explained to the

81 Mercer Human Resource Consulting, *Submission 16*, pp 6–7. Mercer acknowledged that the provision of TFNs for *new* employees are likely to increase significantly as a result of the proposed arrangements that provide when an individual makes a TFN declaration to their employer they are also authorising their employer to provide the TFN to their superannuation fund.

82 Australian Institute of Superannuation Trustees, correspondence received 19 January 2007, p. 3.

83 Ms Raelene Vivian, Deputy Commissioner, Australian Taxation Office, *Committee Hansard*, 30 January 2007, p. 45.

84 Ms Raelene Vivian, Deputy Commissioner, Australian Taxation Office, *Committee Hansard*, 30 January 2007, p. 45.

85 Mr Trevor Thomas, Principal Adviser, Superannuation, Retirement and Savings Division, Department of the Treasury, *Committee Hansard*, 30 January 2007, p. 46.

committee that higher thresholds were examined during the development of the package and why the \$1000 figure had been selected:

Certainly, those sorts of representations were made to the government during the consultation process, that the threshold should be higher, and figures of \$3,000, \$5,000 and \$10,000 were put to the government. The government took the view that the \$1,000 figure essentially struck a balance between the need to protect people who have very small contributions made and therefore may not be in touch with their superannuation fund or the contributions that are being made on their behalf, and the possibility that exists for people to spread contributions across a number of funds in order to not have the penalty for withholding applied to those contributions. For example, if you took a \$10,000 figure, it would be relatively easy for someone who was getting superannuation contributions of \$60,000, or salary-sacrificing to provide for deductible contributions of \$60,000, to spread that across seven superannuation funds and therefore get in under the limit.⁸⁶

3.107 Treasury officials also indicated that although on an accrual basis the revenue generated by the no-TFN tax would be 'small...[i]n terms of a cash revenue estimate, the flow may be of significance.'⁸⁷

3.108 A major implementation concern raised by submitters was the short lead time permitted to affect the changes to superannuation administration systems and processes. Submitters indicated that although the bill allows for TFNs to be provided by 1 July 2008, to comply with various other requirements, such as the need to withhold tax from the benefits of any exiting members who have not provided their TFN, funds need to have their revised administration systems, including TFNs, in place before the start of the new system (1 July 2007).⁸⁸

3.109 Mercer concluded that if the 'extremely high level of TFN provision' is not achieved 'the strain on superannuation funds will be extreme and benefits for a significant proportion of members will be reduced due to the no-TFN tax, which, we expect, will in many cases never be recouped.'⁸⁹

3.110 ASFA expressed its concerns in the following manner:

There remains a legitimate concern that many low and middle income earners could be subject to high rates of taxation on their superannuation contributions due to the failure of their employer to appropriately pass on

86 Mr Trevor Thomas, Principal Adviser, Superannuation, Retirement and Savings Division, Department of the Treasury, *Committee Hansard*, 30 January 2007, pp 47–48.

87 Mr Philip Gallagher, Manager, Retirement and Income Modelling Unit, Department of the Treasury, *Committee Hansard*, 30 January 2007, p. 45.

88 For example Mercer Human Resource Consulting, *Submission 16*, pp 5–8; and Australian Institute of Superannuation Trustees, correspondence received 19 January 2007, p. 3.

89 Mercer Human Resource Consulting, *Submission 16*, p. 7.

the TFN. A strong and concerted effort by the ATO, including an effective public awareness campaign, will be required to ensure employers are fully aware of their obligations to pass TFNs on to superannuation funds.⁹⁰

3.111 The ACCI also raised concern that collection of TFNs will potentially burden employers:

ACCI trusts that these concerns [surrounding the collection of TFNs] can be addressed without imposing costs upon employers. In particular, we are very wary of proposals to require employers to quote TFNs to super funds.⁹¹

3.112 IFSA submitted that there is insufficient time for the ATO, employers and industry to plan and run effective awareness campaigns to reach members by 1 July 2007. It recommended a delay of one year in the commencement of the TFN arrangements to allow the details to be properly worked through.⁹² Many witnesses that appeared before the committee supported this recommendation.⁹³

3.113 Treasury officials opposed the possibility of a deferral, noting the importance of having the TFN arrangements in place when the new package commences to ensure the integrity of the contribution caps:

...it is critical that [the TFN system] operate effectively from day one, because otherwise the opportunity is there for people to exceed the limits in that first year, and that clearly would significantly impact the direction of policy.⁹⁴

Committee view

3.114 The committee agrees that the use of TFNs is a fundamental element of the simplified superannuation package and that their large scale collection poses a significant challenge to its effective implementation. Given the high proportion of matching claimed by the ATO and with the development of an effective education campaign, the committee considers, on balance, that a twelve month deferral of the TFN arrangements is unwarranted.

3.115 To ensure a very high proportion of TFN quotations the government must work collaboratively with the superannuation industry, employers and employee

90 Association of Superannuation Funds of Australia, *Submission 6*, p. 2.

91 Australian Chamber of Commerce and Industry, correspondence, 18 January 2007, p. 10.

92 Investment & Financial Services Association, *Submission 18*, pp 3–4.

93 For example Dr Michaela Anderson, Deputy Chief Executive Officer, Association of Superannuation Funds of Australia, *Committee Hansard*, 30 January 2007, p. 5: and Mr John Ward, Manager, Research and Information, Mercer Human Resource Consulting, *Committee Hansard*, 30 January 2007, p. 20.

94 Mr Trevor Thomas, Principal Adviser, Superannuation, Retirement and Savings Division, Department of the Treasury, *Committee Hansard*, 30 January 2007, p. 46.

organisations in developing the education campaign and the ATO's matching process, to ensure that this critical dimension of the package is delivered effectively. Without concerted effort in this area the government risks undermining the community's confidence in superannuation as a retirement savings vehicle.

3.116 The committee is of the view that notwithstanding the best efforts of the education campaign to collect tax file numbers and the ATO's proposed matching processes, there are likely to be many thousands of individuals where tax file numbers will not be obtained. These individuals will be subject to a 46.5 per cent rather than 15 per cent contributions tax.

3.117 The majority of people for whom tax file numbers will not be obtained are likely to be in lower income and transient occupations who can ill afford an additional higher tax on their contributions. Notwithstanding that they can reclaim the monies in the subsequent three years, the committee notes the evidence from Treasury that the number of individuals and the quantum of higher tax to be collected is significant and a portion will not be claimed by the individuals affected. The committee notes that Treasury and ATO were not able to provide their estimates of these figures to the committee but were taken on notice for response at the Additional Estimates in February 2007.

3.118 In the committee's view the annual \$1000 threshold is too low as it only equates to Superannuation Guarantee payments from an average income of around \$10 000. In order to minimise the impact of this higher tax on individuals who are not engaged in any form of avoidance of contributions limits, the committee considers that a higher threshold should be considered. The committee considers that a higher threshold should be possible which is consistent with both the desire to minimise the impact of the no-TFN tax and the need to prevent abuses of the contribution caps.

Recommendation 6

3.119 The committee recommends that in order to minimise the higher tax on individuals who are not engaged in any form of avoidance of contributions limits the government should consider a higher threshold for the exemption to the no-TFN tax.

Imposition of no-TFN tax on superannuation funds

3.120 Mercer argued that a significant issue with the bill is that liability for the no-TFN tax will be imposed on superannuation providers rather than the fund members. The superannuation provider will be liable for the no-TFN tax at the top marginal rate on any contributions that were made to a member's account without a TFN attached.⁹⁵ Where a TFN is provided in the subsequent three years the fund will be entitled to a tax offset in respect of the 'no-TFN' tax paid.⁹⁶ The tax offset received

95 New section 295-605.

96 New paragraph 295-675(1)(a).

will then be credited to the relevant member's account. When a claim for a tax offset arises due to a failure of an employer to pass on the TFN, the fund will also be entitled to claim interest.⁹⁷

3.121 Mercer posed the problem this way:

We question why a fund should be liable for this tax when the fund has no control over whether the TFN is provided or not. It is the responsibility of the member to provide the TFN. It should therefore be the member who is liable for the tax. The fund's responsibility should be merely to withhold an appropriate amount of tax where required and remit this to the ATO.⁹⁸

3.122 According to Mercer, shifting the no-TFN tax liability to fund members who fail to provide their TFN is 'consistent with the treatment of employment earnings and other interest income where the employer and bank etc withholds the tax which remains a liability of the individual.'⁹⁹ It would also solve a number of other administrative problems including:

- There will be a considerable delay in recouping any no-TFN tax paid. The proposed process involves the fund claiming a tax offset in its next tax return. In effect this is likely to mean that the relevant tax offset may not be received until 12 months or more after the member supplies their TFN;
- In many cases, the member may have left the fund before the TFN is provided adding further to the administrative difficulties in reclaiming the tax. Even if the TFN is provided when the individual is still a member, due to the long delay in reclaiming the tax, membership may have ceased by the time the refund is received. In such cases it will not be possible for the fund to accept the refund (the individual would need to reapply for membership first);
- Even if these membership rules were changed, the fund would then incur considerable cost in tracking the former member and arranging for the refund to be passed on. These costs will normally be borne by all other members as member protection rules will generally mean that costs cannot be passed on to the former member;
- Where a fund is wound up, it will no longer be possible for members to reclaim any no-TFN tax as the fund will no longer be in existence to make the claim;¹⁰⁰

3.123 Mercer outlined its proposals for how a tax withholding facility would work:

97 Explanatory Memorandum, pp 98–99.

98 Mercer Human Resource Consulting, *Submission 16*, p. 9.

99 Mercer Human Resource Consulting, *Submission 16*, p. 9.

100 Mercer Human Resource Consulting, *Submission 16*, p. 9. ASFA also raised the issue relating to former members quoting TFNs: Association of Superannuation Funds of Australia, *Submission 6*, pp 6–7.

...the fund would withhold the tax and then provide the member with a form indicating the tax withheld. The member could then sign the form, add their TFN, the name of the fund they want the refund paid to and send the form to the ATO. The form would also include an authorisation by the member for the ATO to forward the TFN to the [new] superannuation fund. The refund would be obtained more quickly and would be sent to a fund in which the member still had an interest.¹⁰¹

3.124 After the public hearings the committee sought further explanation from Treasury on this issue. Treasury responded with its rationale for the imposition of the no-TFN tax on superannuation funds:

Imposing the liability on superannuation...providers is overall a more efficient method of remitting the tax than if it were imposed on individual members. If the tax were to be imposed on individual members, it would be difficult for the ATO to accurately assess amounts of the liability of individuals who provided incomplete information.

[Imposing the no-TFN tax on individual members] would increase the risk of individuals knowingly withholding their TFNs to test whether or not the ATO was able to assess the liability against them. Imposing the liability on superannuation...providers ensures the tax will be imposed on accounts without a TFN and provide an incentive for members to disclose their TFNs.¹⁰²

Committee view

3.125 The committee recognises that imposing the no-TFN tax on superannuation providers will delay the fund reclaiming withheld no-TFN tax and would cause administrative complexities for funds to manage. On the other hand, the committee notes that imposing the no-TFN tax on individuals would risk the integrity of the contributions caps; a critical aspect of the simplified superannuation package. On balance, the committee is satisfied that in order to protect the integrity of the contributions caps that the bill appropriately imposes the no-TFN tax on superannuation providers. Therefore, the committee considers that change in this area is unwarranted.

3.126 The administrative issues identified by Mercer and other submitters should be considered as part of a subsequent administrative amendments bill as recommended below by the committee.

Deadline for providing TFNs

3.127 The bill proposes an end of the financial year deadline for the provision of TFNs. If this deadline is not met, all contributions made during the financial year will be taxed at the top marginal rate.

101 Mercer Human Resource Consulting, *Submission 16*, p. 10.

102 Treasury, correspondence received 5 February 2007, p. 1.

3.128 Several submitters raised the problem this arrangement will create in a situation where a member's TFN is quoted in the intervening period between the end of financial year and the time an assessment of no-TFN contributions tax is made (which may be many months after the end of financial year). The result according to AXA Australia is:

Under the Bill as currently drafted, where the TFN is received after the end of the financial year in which the contribution is made but before the no-TFN contributions tax is remitted, the tax must still be paid, and a refund can be sought in the next financial year. This disadvantages the member. It will also create administrative complexity for the fund...

Trustees will also need to deal with members who will find it difficult to understand why they have incurred the no-TFN contributions tax after they have quoted their TFN, notwithstanding that the TFN was quoted after the end of the financial year. Many of these enquiries will inevitably be directed to the ATO when a member receives the release authority, in addition interest can only be covered on the amount paid in tax in limited circumstances where an employer has failed to pass on the TFN. Where this is not the case members will forfeit any earnings on the amount paid in tax.¹⁰³

3.129 IFSA also supported the concept that 'funds should not be required to collect "no-TFN" tax if a member provides their TFN after the end of a financial year but before the fund is liable to pay the tax.'¹⁰⁴

3.130 After the public hearings the committee sought further explanation from Treasury on this issue. Treasury responded with a rationale for setting the end of the financial year deadline for the provision of TFNs:

...providing a uniform date by which funds must assess no-TFN contributions income ensures the TFN arrangements for individuals are easy to understand, and provides consistency with the current superannuation contribution reporting periods.

Superannuation funds are able lodge their income tax returns to the ATO at different times depending on their specific circumstances. Having varying dates for assessing whether a TFN had been quoted based on these varying lodgement dates would introduce complexity for individuals.

Further, superannuation funds are able to lodge their income tax returns prior to the due date of lodgement/assessment. Individuals may quote their TFN before this date but after 30 June of the relevant financial year, but after their superannuation provider has lodged its income tax return. This would create the need for providers to amend their income tax returns continually to account for changes to their no TFN contributions income.¹⁰⁵

103 AXA Australia, *Submission 12*, p. 3.

104 Investment & Financial Services Association, *Submission 18*, p. 4.

105 Treasury, correspondence received 5 February 2007, p. 1.

Committee view

3.131 The committee acknowledges the administrative advantages in allowing the collection of TFNs after the end of financial year but before a tax assessment is made. However, the committee considers that in the interests of simplicity and certainty, it is preferable to have the end of financial year established as the single, easily understood and consistent deadline. Therefore, in the committee's view a change to the deadline for the collection of TFNs is unwarranted.

3.132 Nonetheless, the administrative issues identified by submitters should be considered as part of a subsequent administrative amendments bill as recommended below by the committee.

Employment Termination Payments

3.133 DLA Phillips Fox expressed concern over the requirement that employer termination payments be made no later than twelve months after termination. Using as an example the construction industry and the transitional nature of employment within it, they wrote:

There are some cases where the employee will defer claiming payment of the money in the fund on termination of an employment. This usually occurs where the employee is able to find suitable alternative employment relatively soon after that termination, and does not need the money. The employee will defer payment of the money in the fund for another day when circumstances are different.¹⁰⁶

3.134 They were of the view that an exemption to the twelve month rule would not apply in such circumstances and a tax penalty would apply.¹⁰⁷

3.135 Mercer also complained that the transitional rollover provisions are complex and could create inequitable results. In particular, Mercer outlined significant variations on the amount of tax payable depending on whether it is rolled over or taken as cash.¹⁰⁸

3.136 The problem of employer termination payments on death was also raised, particularly where a dispute over entitlements could cause delays. DLA Phillips Fox, acknowledged that relief would, if sought, be likely to be forthcoming in such instances. However, they suggested that many people finding themselves in this situation would not have the wherewithal to access such a ruling.¹⁰⁹

106 DLA Phillips Fox, *Submission 15*, pp 1–2.

107 DLA Phillips Fox, *Submission 15*, p. 2.

108 Mercer Human Resource Consulting, *Submission 16*, pp 20–23.

109 DLA Phillips Fox, *Submission 15*, p. 2.

3.137 Mercer commented on the potential inequities associated with payments by an employer on death. Specifically, Mercer suggested that if an employer paid the benefit directly to the beneficiaries, rather than to the estate, it would attract a lower amount of tax. This is because the \$140 000 threshold would apply to every beneficiary, as opposed to only once if paid to the estate.¹¹⁰

3.138 Mercer also contended that the transitional arrangements specified in employment contracts should also be applied to payments following the death of an employee.¹¹¹

3.139 Finally, Mercer suggested that the measures could generate a raft of pre-July 2007 executive retirements to minimise tax:

...if the employee retires before 1 July 2007 and rolls-over a...\$2 million payment, the total tax payable would have been only \$187,500, considerably less than any of the post June 2007 alternatives. For higher payments, the tax savings resulting from retiring before 1 July 2007 will be even greater. The attractiveness of the pre-July 2007 provisions could lead to decisions by senior executives to retire before 1 July 2007. Where a number of key employees of a company decide to retire, this could place considerable strain on the company.¹¹²

Committee view

3.140 The committee did not pursue this particular issue with Treasury during the course of the inquiry. However, given the potential confusion over the circumstances in which the Commissioner of Taxation may grant an exemption to the 12 month limit, the committee considers that clarification from the government on this issue would be appropriate.

A subsequent amendment bill

3.141 The committee recognises that a number of technical and administrative issues raised by submitters and supported by the committee may not be immediately rectified as they require further industry consultation. Rather than delay the passage of the bills currently before Parliament, the committee considers that a subsequent amending bill is warranted. In these circumstances the committee urges the government to prepare a subsequent amending bill before 30 June 2007 to address such issues, in the interests of the industry and the public.

110 Mercer Human Resource Consulting, *Submission 16*, pp 19–20.

111 Mercer Human Resource Consulting, *Submission 16*, p. 20.

112 Mercer Human Resource Consulting, *Submission 16*, p. 23.

Recommendation 7

3.142 The committee recommends that the government bring on a subsequent amending bill, before 30 June 2007, to address any issues that require further consultation.

Recommendation 8

3.143 Subject to the recommendations made in this report, the committee recommends that the Senate pass the bills.

Senator Ursula Stephens
Deputy Chair

Additional Remarks

Senator Andrew Murray: Australian Democrats

Senate Standing Committee on Economics: Inquiry into the Tax Laws Amendment (Simplified Superannuation) Bill 2006 and five related bills

The Bills

1.1 The Tax Laws Amendment (Simplified Superannuation) Bill 2006 and five related bills implement the Coalition Government's simplified superannuation reforms announced in the 2006 Budget. They are sweeping reforms, and as the main report notes, they will potentially (and materially) affect over 10 million people, 1.3 million employers and more than 310 000 superannuation funds. The new system will apply from 1 July 2007.

Summary of my conclusions

1.2 I have titled this minority report 'Additional Remarks' because I support the Committee Report and do not dissent from it. I welcome the Government's package as a genuine attempt not only to simplify and streamline a complex system, but to provide considerable incentives to encourage increased levels of work and saving.

1.3 That does not mean that I am without caution. In part, that caution is prompted by the difficulty I have in fully assessing the consequences of these changes. Unlike the 'New Tax System' that brought in the GST and related reforms, there is a decided lack of modelling, cameos and detailed projections from the Treasurer and Treasury. Treasury has not provided a long range forecast of tax revenue effects beyond the forward estimates period, which is obviously needed, so there is much uncertainty as to how these measures will affect Australia's financial future.

1.4 In part my caution arises from the question of priority. Is spending \$7.2 billion on superannuation over the next four years the right priority? That is a hard question to answer, given the competing demands on taxpayer funds. By their nature, these reforms are selective in impact. Not everyone benefits or benefits equally. Taxpayers over 60 years of age will benefit most, and wealthier retirees will benefit more than the less wealthy.¹ In my opinion these are not faults of themselves. What is important is whether there are strong compensating programmes and reforms that will significantly improve the lot of Australians who are not in these retirement categories.

¹ For example, the Australian Council of Social Service highlighted its concern that wealthy Australians were the true beneficiaries from provisions contained with the Bill thereby perpetuating 'income inequality in retirement'. Australian Council of Social Service, *Submission 21*, p. 21.

1.5 In part too, my caution is prompted by the sense of a lack of policy balance. These reforms will benefit many Australians, but will particularly benefit better-off Australians. Policy balance and equity requires structural reform in the rest of the income tax system, particularly to benefit low and middle income earners, that should accompany and follow these superannuation tax reforms.

1.6 While recognising that Australians will be grateful for tax relief provided in the 2006 Budget, the Democrats are disappointed that the Government has failed to provide a strategic income tax reform plan. Structural tax reform is essential to make the tax system simpler, fairer and transparent. Our income tax system is complex, inequitable and inefficient. It is widely criticised for its churning effect.

1.7 The Treasurer has adjusted rates and thresholds within the existing system. He needs to change the system to be simpler, broader based and more equitable. The Democrats say a structural income tax reform plan should include raising the tax free threshold significantly to take millions of Australians out of the income tax system; indexing the rates to account for bracket creep; broadening the base by cutting out tax concessions that are inequitable, inefficient, outdated, unnecessary, or distortionary; reforming the tax welfare intersects to encourage welfare to work and remove inequities; and ensuring nominal and effective tax rates remain fair and competitive.

1.8 One frequently expressed concern has been the large potential revenue foregone as a result of this reform. I have however been intrigued by the prospect of this reform being a large revenue-earner, rather than a large revenue-loser. Unfortunately I do not have the means to model this theory, but I will cover these thoughts briefly below.

Is this 'super' reform also going to be a big revenue earner?

1.9 Demographically speaking, we are an ageing population. This social phenomenon throughout the developed world presents a number of specific challenges. Perhaps the most challenging of these challenges is the means by which an increasing number of retirees are able to fund their existence at an affordable public cost.

1.10 The combination of retirement, an ageing population and retirement funding dilemmas are all inextricably linked. The role of Government in managing this complex socioeconomic trend is twofold. It must ensure policies and regulatory mechanisms are in place to enable Australians to effectively save for their retirement, whilst at the same time ensuring that increased concessions to superannuation do not jeopardise future government revenue that will pay for our nation's healthcare, education, infrastructure and other expenses.

1.11 Has the Tax Laws Amendment (Simplified Superannuation) Bill 2006 and related bills struck the right balance? Does it offer the best system to partly and wholly self-funded retirees, low income pensioners and taxpayers alike? How will it fit within Australia's regulatory and tax framework?

1.12 Time will tell.

1.13 Striking a balance between protecting taxation revenue and establishing taxation concessions to encourage Australians to save for their retirement is a delicate, difficult and important task. Although not immediately obvious, this trade-off is representative of the socioeconomic divide that continues to grow within our nation.

1.14 On the one side of the divide exists Wealthy Australia that is empowered to save for their future through a superannuation system that is now well designed for this purpose. On the other side of the divide is Low Income Australia, in retirement reliant upon welfare via a means tested general age pension.

1.15 To fund the retirees of Low Income Australia and to subsidise the retirees of Wealthy Australia, taxes must be generated. The critical issue with regard to this funding dilemma is how the Government proposes to generate the requisite tax income from a projected shrinking taxable working population, to meet the expenses of a retiring population which is forecast to grow substantially.

1.16 The prospect of raising corporate or personal income taxes on a tax base maintained by a smaller proportion of the population is an alternative that is both politically unsavoury and economically unviable.

1.17 A more politically and economically sound alternative is to generate additional tax revenue through incentives to encourage Australians to save for retirement and to work beyond the traditional retirement age of 60.

1.18 Core measures contained within this bill such as the removal of taxation on superannuation benefits from taxed funds after 60 years of age and scrapping the compulsory superannuation payout provisions certainly encourage Australians to work longer and save harder, but this is only half of the story.

1.19 While many of the provisions contained within this bill will encourage more savings to flow into superannuation accounts and Australians working longer will delay the shrinking tax base, the problem that must ultimately be faced by Government is how to fund a growing unfunded general age pension and how to subsidise the growing cost of our hospitals, schools, roads, ports and other resources upon which Australians universally depend.

1.20 Does this 'Simplified Super' bill possibly establish a channel that can, in part, bridge the divide between rich and poor Australia? Surprisingly, and from a counter-intuitive perspective the answer to this question could be yes.

1.21 By removing the benefits tax on superannuation which only applies to wealthy retirees and making a number of other structural changes, the Government is also removing a significant hurdle to investment in superannuation. With significantly greater investment in superannuation the Government could stand to gain substantially from taxation revenue through both the once-off contributions tax, and a tax on

earnings with concessional rates of 15 per cent, at an estimated 7.1 per cent² return respectively.

1.22 This could mean that with money pouring into super and a vast sum of money invested, (which will grow to 'trillions'), the Government has potentially crafted a growing 'taxable' base that could dwarf the present personal income tax base.

1.23 The generosity and clarity of the 'Simple Super' bill is intended to encourage a massive injection of funds into superannuation, which could turn out to be a very significant revenue earner. In turn it could provide the mechanism by which the Government proposes funding the 'savings gap' of low income retirees and the accompanying plethora of subsidised social costs.

1.24 An obvious question arises: if this is so, why has the Government not expounded more on the forecast growth of investment (and therefore tax revenue) in superannuation as a result of the changes contained within the 'Simple Super' bill?

1.25 The answer may be a simple one – until the behavioural effects become apparent, one would have to be cautious in predicting the consequence of enhanced saving investment, particularly if it is thought the investment effect might be modest if funds are simply switched from existing investment vehicles to others in superannuation.

1.26 Scrapping the benefits tax and cleaning up the legislation are the two big 'carrots' that have been proffered, both of which could carry a negligible expense relative to the tax gains that stand to be made from a burgeoning and taxable national superannuation pool. Maybe this is the government's secret future cash cow. Maybe not.

1.27 Time will tell.

1.28 From a big picture perspective, what Australia could progressively experience is a conversion from a taxation system focused on revenue raising via personal incomes with a tax base estimated at \$450 billion presently,³ to an increased reliance on a superannuation system forecast to have \$2 trillion plus under management by 2015 and growing rapidly. The system works because superannuation is a function of both personal income and growing capital; it is a much bigger taxable base, so that it can be taxed at a lower 'concessional' rate and still cover the forecast shortfall in personal income tax raised.

1.29 If this thesis is accurate, then the 'Simple Super' Bill has struck an adequate balance between encouraging more work, and encouraging those that can save for their retirement to do so, whilst at the same time preserving the means to raise taxation revenue to meet forecast welfare and social costs.

2 Treasury estimate after considering dividend imputation etc.

3 Australian Taxation Office, Taxation Statistics 2003–2004.

1.30 Neither Government nor the Explanatory Memorandum has attempted to discuss this possibility. Understandably, the Government is focusing on what taxpayers stand to gain rather than what they may lose in the form of future increased taxation revenue. Broadcasting the value and importance of the national superannuation pool as a potentially progressively more important source of taxation is not likely to be part of the Governments 'spin', particularly if such potential gains are uncertain at this stage.

1.31 I am of the view that the superannuation system, by its very design, is structured to serve Australians with incomes substantial enough to set aside funds for retirement. This is the essence of self-funded retirement. For low and low-to-middle income Australians, their reliance on the superannuation system will be of a very different nature. Their pension will, indirectly, be reliant upon the same system for the taxation returns that the reformed system offers, as opposed to the generation of an income stream substantial enough to self-fund their retirement.

Senator Andrew Murray

APPENDIX 1

Submissions

Submission Number	Submitter
1	R Michael Gill
2	N E Smith
3	PricewaterhouseCoopers
4	Regular Defence Force Welfare Association Inc (RDFWA)
5	JA Graham
6	The Association of Superannuation Funds of Australia Limited (ASFA)
7	Institute of Actuaries of Australia
8	Colin Wade
9	Patricia Graham
10	Bernie McGurgan
11	Trustee Corporations Association of Australia (TCA)
12	AXA Australia
13	National Institute of Accountants (NIA)
14	Small Independent Superannuation Funds Association Ltd (SISFA)
15	DLA Phillips Fox on behalf of trustees of the ACIRT, MERT and BIRST Redundancy funds
16	Mercer Human Resource Consulting Pty Ltd
17	CPA Australia
18	Investment and Financial Services Association (IFSA)
19	Superannuation Australia
20	The Institute of Chartered Accountants in Australia
21	ACOSS

APPENDIX 2

Correspondence Received

1. Correspondence received from Geoff Henkel – Submission to the Simpler Super Taskforce in Treasury
2. Correspondence received from Campbell Simpson
3. Correspondence received from Australian Chamber of Commerce and Industry (ACCI)
4. Correspondence received Australian Institute of Superannuation Trustees
5. Correspondence received from Taxation Institute of Australia
6. Correspondence received from Deacons, trustee for The Redundancy Payment Central Fund and the Redundancy Payment Central Fund No 2.
7. Correspondence received from John Pritchard, Lt Col RAE (Retd)
8. Pitcher Partners, Accountants Auditors and Advisors
9. PricewaterhouseCoopers

Tabled Documents and Additional Information

1. Document tabled at public hearing on Tuesday, 30 January 2007 by Mr Colin Wade - Draft Armed Forces Pension Scheme - Invalid
2. Document tabled at public hearing on Tuesday, 30 January 2007 by Mr Colin Wade - Pensions - Section 641 Income Tax (Earnings and Pensions) Act 2003
3. Answer to question on notice from public hearing on Tuesday, 30 January 2007 received from Association of Superannuation Funds of Australia (ASFA)
4. Answers to question on notice from public hearing on Tuesday, 30 January 2007 received from Mr Colin Wade
5. Additional information provided by Department of Treasury, received 5 February 2007

APPENDIX 3

Public Hearing and Witnesses

Tuesday, 30 January 2007 – Canberra

ADAMS, Commodore Harold John Parker (Retired)
National President, Regular Defence Force Welfare Association

ANDERSON, Dr Michaela, Deputy Chief Executive Officer
Association of Superannuation Funds of Australia

BONEHAM, Mr Patrick, Specialist Adviser
Superannuation, Retirement and Savings Division
Department of the Treasury

BRADY, Ms Helen, MLC Technical Services (Manager, Industry Liaison)
Investment and Financial Services Association

DAVISON, Mr Michael, Superannuation Policy Adviser
CPA Australia Ltd

FORSDICK, Mr Michael James, Partner, PricewaterhouseCoopers
and representative, Institute of Chartered Accountants in Australia

FORSYTH, Mr Stuart, Assistant Commissioner, Australian Taxation Office

GALLAGHER, Mr Philip, Manager, Retirement and Income Modelling Unit
Department of the Treasury

GRAHAM, Mr John, Private capacity

GRIFFITHS, Lieutenant Commander Richard David (Retired), National Secretary
Regular Defence Force Welfare Association

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

LEE, Miss Stephanie, Senior Policy Manager
Investment and Financial Services Association

MORRALL, Group Captain Philip Leslie (Retired),
Vice President, Pay and Conditions of Service
Regular Defence Force Welfare Association

O'SHAUGHNESSY, Mr John, Deputy Chief Executive Officer
Investment and Financial Services Association

ORCHARD, Mrs Susan Janet, Superannuation Technical Consultant
Institute of Chartered Accountants in Australia

PETERSON, Mr Brett, Assistant Commissioner
Australian Taxation Office

PRAGNELL, Dr Brad, Director, Policy and Best Practice
Association of Superannuation Funds of Australia

RAY, Mr Nigel, General Manager, Tax Analysis Division
Department of the Treasury

THOMAS, Mr Trevor John, Principal Adviser
Superannuation, Retirement and Savings Division
Department of the Treasury

VIVIAN, Ms Raelene, Deputy Commissioner
Australian Taxation Office

WADE, Mr Colin, Member
Regular Defence Force Welfare Association

WARD, Mr John David, Manager
Research and Information, Mercer Human Resource Consulting