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VAM:abr

24 January 2007

Committee Secretary
Senate Economics Committee
Department of the Senate
PO Box 6100
Parliament House
CANBERRA ACT 2600

Dear Sir

INQUIRY INTO THE PROVISIONS OF THE TAX LAWS AMENDMENT (SIMPLIFIED SUPERANNUATION) BILL 2006 AND FIVE RELATED BILLS

We have reviewed the amending Bills introduced on 7 December 2006 and wish to bring to the attention of the Committee some important issues that do not appear to be addressed in the submissions received to date.

Superannuation Death Benefits

In our view the Bills do not adequately address existing pension arrangements which are structured to revert to children of the primary pension recipient on death. The intention of the amendments appears to be to void these arrangements with effect from 1 July 2007 where the reversionary beneficiary falls outside of the definition of 'death benefits dependant'.

We argue that retrospective application of this nature is inappropriate where legitimate arrangements have been put in place before any announcements regarding superannuation reform were made. The unfairness of the amendments in this regard is also compounded through the failure of the Bills to provide any alternatives to individuals receiving non-commutable pensions structured in this manner.

We ask that the Committee consider the impact of the Bills on existing pensioners with binding arrangements of this type. An appropriate outcome would be to provide grandfathering of existing arrangements or the ability to revise pension arrangements which would become void under the proposed amendments.

We discuss this issue in greater detail in the attachment to this letter.

Allocation from Fund Reserve

We note that the Bills provide a broad regulation making power to capture amounts allocated from fund reserves as a concessional contribution of the receiving fund member. We are concerned that regulations made for the purpose of this section may capture allocations from pension reserves after the death of a lifetime pension recipient and ultimately result in additional tax of 31.5% applying on amounts that have already been taxed.

We ask that the Committee consider the benefits of including specific exceptions to this general regulation making power. In particular, we would strongly support the inclusion of a specific exception where an allocation is made from a pension reserve arising on the death of a lifetime pension recipient.

Such an exception would provide certainty of the tax treatment applying after death. It would allow the pension recipient to assess the appropriateness of their current arrangements against other options available (we note that there are no alternative options in the case of a complying lifetime pensioner).

Without this certainty, existing pensioners cannot determine the ultimate tax treatment likely to apply to superannuation assets after death. The regulation making power may or may not capture allocations from the pension reserve to remaining fund members and impose additional tax at 31.5%.

We argue that without this certainty the Bills potentially impact retrospectively on legitimate arrangements entered into before any superannuation reform announcements were made.

We also discuss this issue in greater detail in the attachment to this letter.

Pitcher Partners Melbourne provides accounting and audit services to in excess of 550 Self Managed Superannuation Funds. At present we have more than 20 pensioners receiving lifetime pensions who may be adversely impacted if the Bills are passed in their current form.

If you require any further information in relation to these matters please contact me on 03 8610 5100.

Yours faithfully
PITCHER PARTNERS

V A MACDERMID
Partner

ATTACHMENT

Superannuation Death Benefits

Subdivision 302-C of the Tax Laws Amendment (Simplified Superannuation) Bill 2006 does not contemplate dealing with pensions in existence at 1 July 2007 that have existing reversionary arrangements for non tax dependants. The Explanatory Memorandum at paragraph 2.69 states:

> *"from 1 July 2007, a person who is not a dependant of the decreased will not be able to receive a superannuation income stream under amendments to be made to the Superannuation Industry Supervision Regulations 1994."*

Amending regulations, released for comment, will insert sub-regulation 6.21(2A). This provides that if a member dies on or after 1 July 2007, their pension may only revert to a dependant of theirs who is a child if the child is:

- Less than 18 years of age: or
- Between 18 and 25 years of age and financially dependent on the member: or
- Has a disability of the kind described in subsection 8(1) of the *Disability Services Act 1986*.

This provision would prevent any pension reverting to an adult child on the death of the member, regardless of when the pension came into existence and regardless of the existing terms of the pension.

We have among our client base a number of existing pensions where one of the pre-agreed terms of the pension is that the pension will revert upon the member's death to one or more adult children of the member. The Bills and associated regulations completely disregard these existing arrangements.

Consequences of Change

Where a member commences a lifetime pension and names an adult child as a reversionary, the fund actuary must take into account the life expectancy of the reversionary as well as the life expectancy of the original pensioner in determining the first year pension. The first year pension is then increased by indexation each year for the life of the pension.

Obviously if the pension has to last for the life of the member (parent) and reversionary (child), the first year pension would be smaller than would be the case if no reversionary was named. What adjustment, if any, can be made to the pension amount being paid for this style of pension if the pension cannot revert to the named reversionary?

The pension amount of an existing lifetime pension can effectively be amended by commuting the existing pension and commencing a new lifetime pension immediately from the same underlying assets. However, if the lifetime pension is being paid from a self managed superannuation fund, the fund is prohibited from commencing a new lifetime pension after 31 December 2006.

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 non-commutable 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.

The stated policy approach that amendments will not be made extending the ability for fund members receiving lifetime pensions to commute those pensions is not particularly helpful in addressing the circumstances outlined above.

When a deductible amount is calculated at the commencement of a pension, the undeducted purchase price (UPP) must be divided by the longer life expectancy of the member or of any named reversionary to the pension. Where a named reversionary is an adult child their life expectancy will be used for this calculation. As a result, the deductible amount that the pensioner receives each year will be a far smaller amount. For example, if the UPP of a pension was $100,000 and the life expectancy of the member was 20 years, the deductible amount would be $5,000 pa. If the member named a reversionary with a life expectance of 40 years, the deductible amount would be $2,500 pa.

Given that the pension has already commenced and the deductible amount calculated, what is to happen to this deductible amount if the pension is not allowed to revert to the named reversionary?

We note that Section 307-125 of the principal Bill only allows an existing pensions deductible amount to be recalculated if the existing pension is commuted and a new pension commenced.

Allocation from Fund Reserve

We are concerned about the impact of proposed subsection 292-25(3) of the principal Bill. This provision may treat amounts allocated from a reserve in a superannuation fund to a member as concessional contributions of the member. The allocation would apply against the member's concessional contributions limit.

If an amount is allocated from a reserve to a member and that amount, in conjunction with other concessional contributions received, exceeds the member's concessional contributions cap, the member will be assessed on the excess (including the allocation from the reserve) at 31.5%. This is stated to be an integrity measure to protect the contribution limits regime.

It is important to note that amounts held in a reserve in a superannuation fund have already been taxed. If the reserve arose from contributions to the fund, those contributions would have been taxed by the fund on receipt. If the reserve arose from income or capital gains, those amounts would have been taxed in the year the earnings were derived.

It seems extraordinarily unfair to contemplate taxing these amounts again on allocation to members of a fund in certain circumstances at 31.5%.

Earlier in this letter we addressed the issue of lifetime pensions and that certain arrangements would be void under the provisions of the Bill. In particular, we discussed the inability for a pension to revert to an adult child of the beneficiary on death after 1 July 2007 regardless of when these arrangements were put in place.

This policy approach will naturally lead to an increase in the reserves maintained by funds paying pensions which have been structured to revert to adult children. Assets previously required to meet the fund's longer term pension obligations will be surplus to the fund's needs at 1 July 2007.

Upon the death of the primary beneficiary, these assets must fall to a reserve in the fund. The trustee has no right to pay out any remaining assets to the dependants or estate of the deceased.

Any allocation of assets from the reserve to other members, typically family members of the deceased to provide for their retirement, can now potentially be taxed at 31.5%. This seems extraordinarily unjust and the most likely consequence is that the amounts will be retained in the reserve indefinitely.

A better policy approach may be to restrict the creation of reserves moving forward rather than taxing existing reserves that arise from the historical operation of the superannuation industry and where the proceeds are used for the benefit of remaining fund members in retirement.

When this issue is considered in the context of the earlier issue discussed the impact on members with existing complying lifetime pensions can be significant. The pensioner will not be allowed to carry out their previously planned arrangements (revert the pension to their child), they are not allowed to commute or change their existing pensions, and if any assets are left upon their death and fall to a reserve, the amount may be punitively taxed if allocated to other fund members.