16 January 2007

The Secretary
Senate Standing Committee on Economics
Parliament House
Canberra ACT 2600
Email: economics.sen@aph.gov.au

Dear Peter

The Institute of Chartered Accountants in Australia (The Institute) is pleased to make the following submission to the Committee's Inquiry into the *Tax Laws Amendment (Simplifed Superannuation) Bill) 2006* and five related Bills. The Institute is one of Australia's peak professional bodies and our members represent many of Australia's leading business and finance professionals. These members act as advisers and key decision-makers in all facets of the superannuation industry.

The submission has been prepared with the assistance from many members in their capacity as trustees, service providers and fund members of funds of all sizes.

We greatly value the opportunity to be involved in the consultation process on these important reforms. We have focused our submission on matters where we believe further simplification is possible or where the measures fail to support the Government's efforts in other areas.

Should you have any queries please do not hesitate to contact the Institute's Manager of Government Relations, Dr Barbara Carney, on 62820591or via email at carney@icaa.org.au.

Yours sincerely

Bill Palmer
General Manager
Standards and Public Affairs

Deductibility of Superannuation Contributions

Deductibility of Superannuation Contributions
Section 290-160 enables a person who has employment income of less than 10% of their assessable income plus reportable fringe benefits to claim a personal tax deduction for superannuation contributions as well as being eligible for an employer deduction. The legislation proposes to introduce caps on the amount of deductible contributions that can be made. The way that this would work is as follows: if an individual's employer does not permit salary sacrificing into superannuation, and/or the individual earns say $30 000 per annum from employment but has other assessable income, then they cannot utilise the full $50 000 superannuation contribution deduction. On the other hand, a person who either does not work but has assessable income, or is self-employed, or who is employed in a permanent arrangement earning more than $50 000 per annum, is able to claim up to the $50 000 maximum contribution. The Institute contends that this provision introduces an artificial distinction as to the source of the income, and has the effect of preventing some people from maximising their savings, as they will not be able to top up their superannuation contributions because of the 10 % limit.

The Institute **recommends** that the restriction be removed altogether, allowing all Australians to make their maximum deductible contribution regardless of how income is earned

Transfer of Overseas Superannuation Benefits
In the 2006 Budget a change was announced to current arrangements that will effectively cap the transfer of non-taxable overseas retirement savings to Australia at $150,000 per member per year. This may be aggregated to $450,000 for a three-year period where the work test is met. Non-taxable overseas retirement savings are the capital saved in a foreign pension fund prior to becoming an Australian resident.

The taxable component of a benefit is broadly calculated as the amount of income growth in the period while the person is an Australian resident. A person is exempt from this tax when the benefit is transferred within six months of becoming a resident.

Due to the complexity of the interaction between Australian and overseas retirement income regimes this may result in expatriates returning to Australia and migrants, electing not to bring monies to Australia.

Some key impacts of this change are that:

- 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 single payment to an approved fund;

- Where the benefit is retained in the UK it is paid in Australia as a fixed income stream, i.e. no indexation, which is subject to income tax. In real terms this may see the individual becoming an increasing burden on the Australian taxpayer through increased access to social security benefits. However, monies transferred from the UK to Australia must be paid as a complying income stream. This means that the benefits may keep parity with inflation and be invested in the local economy. The Institute believes that the latter arrangement is a better solution for the individuals concerned and for the broader community;

- The limit of $450,000 may be exceeded due to exchange rate fluctuations, which occur between commencing the payment process and completion of the transaction. The transaction may take up to six months to complete due to the evidence required by the foreign fund that the Australian fund meets UK legislative requirements;

- An expatriate remitting monies saved overseas will be subject to the caps and therefore restricted when making undeducted contributions in the subsequent three years.

While there are benefits to the taxpayer of bringing monies into Australia as the income will be tax free in retirement, consideration needs to be given as to how to equitably remit these monies to Australia to ensure our economy continues to benefit from people consolidating their financial resources in Australia.

The Institute **recommends** that this matter be reconsidered and legislation put in place to enable those returning to Australia or permanently migrating to Australia to consolidate their retirement savings in the Australian superannuation system.

Residency test
This legislation proposes to amend the residency test by removing the temporary absence rule. This rule was introduced to enable trustees of SMSFs who are out of Australia to retain their SMSF in order to make provision for retirement. In order to retain the SMSF under the current rules the trustee is required to return to Australia for 28 consecutive days in a two year period to maintain the funds resident status.

The difficulty with the amended test is that some funds may cease to be compliant on 1 July 2007 as the funds' trustees are currently working overseas and may be deemed to be 'ordinarily' out of Australia and hence a non-resident.

The Institute **recommends** that the legislation be amended to ensure that the existing residency test be maintained, or, at a minimum, that a transitional approach be adopted to enable the orderly restructure of funds.

Taxes on death benefits
There are two issues associated with death benefit taxes.

The first is that where a person over 60 is of ongoing ill health they are able to plan their finances and, if they so chose, remove all monies from their superannuation tax free and distribute these assets tax free to beneficiaries. However, if a death results from an accident or critical event such as a heart attack the distribution of any residual assets may result in tax being payable by the beneficiary(ies).

The Institute **recommends** that the balance of all superannuation benefits remaining after the death of a person over 60 be made tax-free.

The second issue arises where a person under age 60 with dependent beneficiary(ies) under age 60 dies. Should the beneficiary(ies) take a lump sum it is paid tax-free. However, when a pension is taken the income is assessable with a 15% tax offset available. This discourages the taking of a pension benefit.

The Institute **recommends** that all death benefit pensions from taxed funds be treated as non-assessable income.

Taxes on pensions from untaxed schemes

The Institute believes that the new provisions will introduce an inequity for people receiving pensions from untaxed schemes and who have other taxable income. This arises due to the tax treatment of the benefit payment as compared to a benefit received from a taxed scheme.

A person aged 60 or above in receipt of a benefit from a taxed fund will receive the income free of tax and will not report the income as assessable on their tax return. They will therefore be assessed at marginal tax rates on other income. For example, Mr A has a $15,000 pension and $20,000 of other assessable income. The tax payable is $2,100 i.e. tax rate of 15% applied to amounts over the tax-free threshold of $6,000.

However, a person aged 60 or above in receipt of a benefit from an untaxed fund will be taxed at marginal rates with a tax offset of 10% on pension income. This income will be reported as assessable and may lead to bracket creep. For example, Mr B has a $15,000 pension and $20,000 of other assessable income. The tax payable is:.

Taxable income $35,000

Tax Free $6,000	Nil	$ 0
$6,001 - $25,000	15%	$2,850
$25001 - $35,000	30%	$3,000
Less tax offset on pension	10%	($1,500)
Tax payable		$4,350

The example demonstrates that the method of calculating the tax on the income has resulted in the additional income being taxed at a higher rate for a pensioner receiving a benefit from an untaxed fund.

The Institute **recommends** that the ATO be asked to quantify the impact of the problem and that the Government consider a tax offset to ensure this group are not adversely affected.