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Committee Secretary
Senate Standing Committee on Economics
PO Box 6100
Parliament House
CANBERRA ACT 2600

Email: economics.sen@aph.gov.au

Subject: **Inquiry into the Tax Laws Amendment (2009 Budget Measures No. 1) Bill 2009**

Dear Sir

Thank you for the opportunity to provide our comments on this Bill. We are disappointed that there will be insufficient time available at the Public Hearing for us to present our views verbally to the Committee.

Our interest relates to Parts 2 and 3 of the Bill and our comments on these Parts are attached.

We are particularly concerned with the changes to the concessional contribution limits. These reductions in the limits are extreme and follow other reductions in the limits that occurred as part of the Simpler Super changes in 2007. From 1 July 2012, for members over age 50, the new limits will be **less than 20%** of the limits based on the pre-Simpler Super rules.

The new limits will considerably restrict the ability of many Australians to save for their retirement through superannuation. This will particularly hurt those who have been unable to save in earlier years due to periods out of the workforce (eg to raise children) or who have had other priorities in earlier years. The limits are also expected to reduce the funds available for long term saving in Australia.

The reduced limits will also result in considerably more Australians exceeding the limits which will result in tax at above their marginal income tax rate and thereby present a very negative message about superannuation.

Particular problems will arise in relation to defined benefit funds. The announcement of the reduced limits has effectively put the rationalisation of defined benefit arrangements on hold. Due to existing inappropriately drafted Regulations, defined benefit members can be adversely affected to a significant extent following a successor fund transfer. Rationalisation of defined benefits arrangements by converting them to accumulation has also become considerably more difficult. Significant changes to current Regulations will be necessary to remove these barriers.

Whilst we are less concerned with the changes to the co-contributions, these changes and the changes to the contribution limits will not only increase costs for trustees, they will also lead to a reduced level of confidence in the stability of the superannuation rules.

We recommend that the reductions in the concessional contribution limits do not proceed.

If the reductions do proceed, then we recommend that:

- a higher indexed limit be retained for those over age 50 (ie beyond 30 June 2012), many of whom are in “catch-up” mode as they have not had the ability to fully utilise superannuation throughout their working life. The new limit could be twice the limit for those under age 50;
- the Bill and existing Regulations be amended and appropriate new regulations introduced to:
  - enable the grandfathering provisions for defined benefit members to transfer to a successor fund and hence avoid the barrier to rationalisation that will otherwise result;
  - enable the grandfathering provisions to continue for defined benefit members who change benefit category (where such changes are in accordance with fund/employment rules as at 5 September 2006);
  - clarify that the grandfathering provisions can continue where the transferred assets were less than the value of the transferring interests and where minor changes or reductions occur which would not have caused loss of grandfathering had they occurred in the original fund;
  - fix problems for some State Public Sector schemes who appear to be subject to limits on both notional contributions and benefits; and
  - consult with the industry to fix other problems related to notional contributions that currently exist; and

- the need for employers to include reportable employer superannuation contributions on Payment Summaries be reviewed as the costs (and confusion) involved are likely to outweigh the advantages if concessional contributions are to be restricted as planned.

We would be happy to discuss our concerns. If you wish to do so, please contact John Ward on 03 9623 5552.

Yours Sincerely

John Ward
Manager Research and Information

ATTACHMENT

DETAILED COMMENTS ON THE TAX LAWS AMENDMENT (2009 BUDGET MEASURES NO. 1) BILL 2009

SECTION 1: Changes to concessional contribution limits

We are strongly opposed to the proposals to reduce the concessional contribution limits. Such a reduction will have a very considerable impact on many Australians who are saving for their retirement.

We detail a number of our concerns below:

Size of change

The proposed changes are much more significant than implied by the Government announcement that the limits are to be reduced from $50,000 a year to $25,000 a year.

If no changes are made, the concessional contribution limit would increase to $55,000 from 1 July 2009 due to indexation (as already announced by the ATO before the Budget announcements). Thus the reduction is actually a 55% reduction rather than a 50% reduction.

Further, indexation only occurs when the cumulative indexation exceeds $5,000. Under the current rules, the next indexing of the limit would have been expected in 2012 (assuming 4% pa AWOTE increases). However under the Government's proposals, the next indexation is now not likely until 2014. In other words, from 1 July 2012, the proposed limit is expected to be $25,000 compared to an expected limit under the current rules of $60,000, a reduction of almost 60%.

We also note that the original Simpler Super changes resulted in significant reductions in the effective contribution limits (previously there were age based limits for tax deductibility purposes). For those over age 50, these limits would be approximately $118,000 by 1 July 2009 and $132,000 by 1 July 2012. In other words, by 2012, the limits for those over age 50 will have **reduced by over 80%** compared to the pre-Simpler Super rules.

This very significant reduction could be partly offset if a higher limit continued to apply to those aged 50 and over beyond the current date of 30 June 2012 when the current transitional limit for this age group expires.

Alternative investment options

If the new limits are introduced, the amount of funds available for long term investment through superannuation funds (with their preservation rules) will be less than it would otherwise have been.

We note that non-superannuation savings are not subject to the preservation requirements imposed on the superannuation system and hence can be of much shorter term in nature.

The new limits will result in people seeking alternative savings vehicles.

We are concerned that these may often include:

- short term savings options (and potentially low return);
- less diversified portfolios than available through superannuation funds;
- further investments in the principal residence; and/or
- various tax advantaged investment schemes which may have been made for the tax advantages rather than the intrinsic worth of the underlying investment.

Such strategies may not be in the long term interests of either the person involved or Australia.

Impact on accumulation members

In a number of cases, whether due to the Scheme rules, employer policies, legislation or an enterprise bargaining agreement or similar, contributions exceed 9% of salary. The lower limits will result in a significant increase in the number of employees who exceed the limits. It may not be possible for the employee to opt out of these contributions.

The new limits will mean that some employees earning, say $100,000 to $150,000 will be subject to excess contributions tax. This will result in a tax on superannuation contributions of the normal 15% contribution tax plus the excess tax of 31.5%, a total of 46.5%. This is a higher rate than would be applicable to their marginal income and is hence a penal tax rate.

Global Financial Crisis

As a result of the global financial crisis, many members' account balances have fallen considerably. We expect that many people may wish to make additional contributions to top up their superannuation and offset part of the fall in account values. The introduction of the lower contribution limits will considerably restrict the ability to replenish their superannuation.

Lifetime funding

Many people have been unable to save for their retirement on a consistent basis over their lifetime. For example, younger and middle aged workers may have other priorities such as:

- saving for a home deposit;
- paying off a mortgage; and
- raising a family (often on one income per couple rather than two incomes).

Only once these other priorities have been attended to, can any significant voluntary superannuation saving be achieved.

Similarly, many people do not have a full career in the full-time workforce with:

- tertiary studies now extending well into the late twenties in some cases;
- extended periods out of the workforce due to child care commitments;
- periods of unemployment.

Many people have therefore been deferring any significant saving for retirement, intending to boost their saving as they approach retirement. Now their ability to make such savings has been considerably reduced due to yet another rule change.

We believe that a higher ongoing cap is necessary for older members. This cap should be indexed and continue to apply beyond 30 June 2012 to enable older members to "catch-up".

Impact on defined benefit members

Special rules currently apply to defined benefit members. Rather than actual contributions applying (as these are not individually calculated or allocated to members), a notional concessional contribution is applied. Subject to conditions specified in the Regulations, the notional defined benefit contributions are capped at the member's concessional contribution limit (for members as at 5 September 2006). We call this capping of notional concessional contributions the "grandfathering provisions".

With the current concessional contribution limit of $50,000, this grandfathering provision only has an impact for a relatively small number of members. With the significant reductions in the concessional contributions limit, the importance of grandfathering will become much more critical.

We note that the Bill includes grandfathering provisions for defined benefit members in a scheme as at 12 May 2009. Similarly to the current legislation the Bill provides scope for the grandfathering provisions to carry across to a successor fund when two funds merge, subject to conditions specified in the Regulations. At this stage, details of these conditions have not been made public.

However we note, with great concern, that the conditions applicable to the current grandfathering provisions are extremely onerous. We consider that these provisions are unfair and, we believe, may not represent the intention of Parliament.

Our major concerns relate to the following:

Successor fund transfers

The Parliament deliberately legislated to provide that the grandfathering provisions could carry across to a successor fund following a fund merger (Section 292-170 of the ITAA 1997) provided equivalent benefits were provided in the continuing fund. However the conditions imposed by the Regulations mean that even in cases where identical benefits are provided, the grandfathering provisions can rarely be carried across. This is generally because the actuary is required to recalculate the notional contributions using a different (and inappropriate) assumption about the average age of new entrants. This results in an increase in the notional contributions (even if benefits are unaltered) which leads to an automatic failure to meet the conditions. We believe that this problem is caused by a flaw in the drafting of the Regulations rather than a deliberate intention of Parliament.

Whilst this has been a problem since 1 July 2007, the number of members who might have been adversely affected has been relatively small. With the proposed lower caps, the seriousness of the problem has been magnified to the extent that it will generally be no longer possible for a successor fund transfer of defined benefit members to occur unless more appropriate conditions are included in the Regulations. **Without such changes to the Regulations, the reduction in the concessional contribution limits will be a very significant barrier to the rationalisation of defined benefit funds. Yet rationalisation is a desired policy from the Government's retirement income policy perspective.**

There are also other technical problems with the current grandfathering provisions in the Act and the Bill which also need to be addressed in relation to successor fund transfers.

Transfer of categories

Under the current Regulations the grandfathering provisions can also be lost when a member transfers benefit category.

This can include transfers as a result of a promotion where the fund rules provide higher benefits for senior employees. This can result in employees being worse off following a promotion with the excess contribution tax potentially exceeding the increase in their benefit. We consider it unreasonable that the grandfathering provisions can be lost, particularly where the rules in place in relation to the fund on 5 September 2006 have not been amended. (In other cases, members are required to transfer to a different fund following a promotion and again the grandfathering provisions will be lost even though the rules of the relevant funds are unchanged.)

Members can also lose the grandfathering provisions if they have the option to transfer to a category providing higher benefits. Again we consider it unreasonable that the grandfathering provisions can be lost if there has been no change to the fund rules since 5 September 2006.

Lack of clarity in Bill (and current Act)

In order for the grandfathering provisions to be transferred, the Bill (and the current Act) requires:

1. That the "entire value of the transferring interest" be transferred (proposed section 292-170(9)(c)). This wording raises question marks as to whether a defined benefit arrangement in an unfunded scheme would qualify if a successor fund transfer occurred – as there may be no assets to transfer. It would be unreasonable if the grandfathering provisions were not transferrable just because the fund's assets were less than the value of the transferring interests.

2. That the member's rights to accrue future benefits under the new fund are equivalent to the rights to accrue future benefits in the old interest (proposed section 292-170(9)(d). There is no definition of equivalent. It is unclear whether minor changes in rules (which would not otherwise impact on the notional contributions) would result in the loss of the grandfathering provisions or in fact whether a subsequent reduction in benefits could also result in the loss of the grandfathering provisions. We note that the grandfathering provisions would not be lost if such minor changes or reductions occurred in the original fund.

It is important that the Bill (and the provisions in the current Act) be amended to clarify that the grandfathering provisions will not be lost in these circumstances.

Other problems

There are many other problems which have arisen with the current Regulations in relation to defined benefit members. In many places, the Regulations are ambiguous or unclear or produce what we would consider to be unreasonable results. Many of these problems were highlighted by industry during the drafting process but appropriate modifications to draft regulations were not made. Whilst, until now these problems have impacted on few members, the proposed reduction in the concessional contribution limits will now impact on a significantly greater number of members.

It is critical that the Government consults with the industry to rectify the current problems with the Regulations.

Impact on Federal Parliamentarians and public servants

It is interesting to note that there were no changes to the rules for many untaxed arrangements such as the defined benefit arrangements for members of Federal Parliamentary and the Federal Public Service. Concessional contributions do not apply to such arrangements – rather a cap is applied to the level of benefits which can be taken at a concessional tax rate. Whilst the Henry review is expected to comment on this later in the year, if changes are to be made, as announced in the Budget, it would be preferable to adopt a consistent approach to all schemes.

Impact on various State Government Schemes

The current legislation applicable to State public sector schemes is extremely complicated. It appears that the legislation was drafted taking into account Federal public sector schemes whilst not appropriately taking into account State schemes.

Based on advice from the ATO, we understand that some State schemes may be subject to both the concessional contribution limits as well as the restrictions on concessional tax treatment of benefits. With the reduction in concessional contribution limits, there is now an urgent need to clarify the intention of the legislation and to remove the double barrier of contribution and benefit limits for these schemes.

Impact on member sentiment

Governments are continually changing the rules relating to superannuation. As superannuation can only be accessed in limited circumstances, it is important that Australians can rely on consistent legislation. Continual changes such as this are likely to undermine people's confidence in the stability of the superannuation legislation.

Impact on administration costs

The changes to the concessional contribution limits also have flow on effects on the costs of administering superannuation funds. Trustees will incur further costs in:

- communicating the change to members;
- amending Product Disclosure Statements and other communication material, including websites;
- amending web-based benefit calculators;
- potentially amending scheme designs;
- responding to member queries (and potential complaints when an excess contribution tax assessment is received); and
- processing payments of excess contributions tax (a significant increase in excess tax assessments is expected).

The Government regularly criticises superannuation funds for high expense levels, but many of the costs involved are the result of continual adjustment of legislation.

93% tax rate problem

In some cases, the tax on contributions (or notional contributions) can be as high as 93%. This can occur because excess concessional contributions are also treated as non-concessional contributions. If the non-concessional contribution limit is also exceeded, some contributions will be subject to the normal 15% contribution tax, the 31.5% excess concessional contributions tax and the 46.5% excess non-concessional contributions tax giving a total tax of 93%. The reduction in the contribution limits will increase the likelihood that some members will inadvertently be subject to this 93% tax rate.

Reportable employer superannuation contributions

A change announced in last year's Budget (and subsequently legislated) was for employers to report certain salary sacrifice (and some other employer contributions) on Payment Summaries. Such contributions have become known as reportable employer superannuation contributions. From 1 July 2009, these will be considered to be income for the purposes of various income tests (eg co-contributions, Medicare Levy surcharge and several other purposes). This is already resulting in additional costs and confusion for employers.

However, if the concessional contribution limits are reduced as proposed in the Bill, then it can be expected that voluntary salary sacrifice contributions will reduce considerably. Hence the amounts included on Payment Summaries will be considerably lower than previously anticipated. We consider that the requirements (and associated costs) for employers to report certain contributions on Payment Summaries can no longer be justified if the lower concessional contribution limits are introduced.

Recommendations – concessional contribution limits

The reduction in the concessional contribution limits is inappropriate and should not proceed.

If the reductions do proceed, then we recommend that:

- a higher indexed limit be retained for those over age 50 (ie beyond 30 June 2012), many of whom are in "catch-up" mode as they have not had the ability to fully utilise superannuation throughout their working life. The new limit could be twice the limit for those under age 50;
- the Bill and existing Regulations be amended and appropriate new regulations introduced to:
  - enable the grandfathering provisions for defined benefit members to transfer to a successor fund and hence avoid the barrier to rationalisation that will otherwise result;
  - enable the grandfathering provisions to continue for defined benefit members who change benefit category (where such changes are in accordance with fund/employment rules as at 5 September 2006);
  - clarify that the grandfathering provisions can continue where the transferred assets were less than the value of the transferring interests and where minor changes or reductions occur which would not have caused loss of grandfathering had they occurred in the original fund;
  - fix problems for some State Public Sector schemes who appear to be subject to limits on both notional contributions and benefits; and
  - consult with the industry to fix other problems related to notional contributions that currently exist; and

- the need for employers to include reportable employer superannuation contributions on Payment Summaries be reviewed as the costs (and confusion) involved are likely to outweigh the advantages if concessional contributions are to be restricted as planned.

SECTION 2: Reduction in Government co-contribution

There are several important points which need to be made in respect of co-contributions. These include:

1. This is only a temporary reduction and the reduced co-contribution of a dollar for dollar contribution up to a maximum of $1,000 pa is still a valuable benefit.

2. The reduction in the co-contribution rate coincides with another change which has already been legislated which will further reduce the co-contribution available for many members. This change involves a change in the income test which needs to be satisfied to qualify for the co-contribution. From 1 July 2009, income taken into account will include the member's:

- assessable income; plus
- reportable fringe benefits; plus
- reportable employer superannuation contributions.

Whilst assessable income and reportable fringe benefits are already included for income test purposes, reportable employer superannuation contributions will be added from 1 July 2009. Reportable employer superannuation contributions include most salary sacrifice contributions and some other voluntary employer contributions. As a result of the change to the income test, many members will no longer qualify (or will be subject to a significantly lower co-contribution), even without the reduction in the co-contribution. It is likely that many members will be unaware of this change, despite information being provided by superannuation funds. Superannuation fund trustees will generally not be aware of the level of reportable employer superannuation contributions as these are determined by employers (using a complex set of rules) and recorded on Payment Summaries provided after year end. This will make it significantly more difficult for members to ascertain their potential eligibility for a co-contribution.

3. The double impact of the above changes is likely to reduce the confidence of members in the stability of the superannuation legislation, particularly if they make a contribution and receive a significantly lower co-contribution than expected (or none at all). If the Government wishes Australians to save for retirement, then continually changing the rules does not help.

4. The temporary changes in the co-contribution also have flow on effects on the costs of administering superannuation funds. Trustees will incur further costs in:

- communicating the change to members;
- amending Product Disclosure Statements and other communication material, including websites;
- amending benefit calculators; and
- responding to member queries (and potential complaints when a lower than expected co-contribution is received).

Summary – co-contributions changes

Whilst the reduction of the co-contribution in itself is not a major concern, it is important to recognise the impact on member sentiment and the impact on costs of regularly changing superannuation legislation.

We would prefer that the changes do not occur.