The Parliament of the Commonwealth of Australia

REPORT
ON THE PROVISIONS OF THE NEW BUSINESS TAX SYSTEM (MISCELLANEOUS) BILL (NO. 2) 2000

SENATE SELECT COMMITTEE ON

SUPERANNUATION AND FINANCIAL SERVICES

June 2000

The Parliament of the Commonwealth of Australia

REPORT
ON THE PROVISIONS OF THE
NEW BUSINESS TAX SYSTEM
(MISCELLANEOUS) BILL (NO. 2) 2000

SENATE SELECT COMMITTEE

ON SUPERANNUATION AND FINANCIAL SERVICES

June 2000

Commonwealth of Australia

ISBN 0 642 71089 9

This report was printed by the Senate Printing Unit, Parliament House, Canberra, ACT 2600.

SENATE SELECT COMMITTEE ON SUPERANNUATION AND FINANCIAL SERVICES

MEMBERSHIP

Senator John Watson (Chair)	(Tasmania, LP)
Senator the Hon Nick Sherry (Deputy Chair)	(Tasmania, ALP)
Senator Lyn Allison	(Victoria, AD)
Senator Grant Chapman	(South Australia, LP)
Senator Stephen Conroy	(Victoria, ALP)
Senator John Hogg	(Queensland, ALP)
Senator Ross Lightfoot	(Western Australia, LP)

Secretariat

Ms Sue Morton, Secretary

Ms Robyn Hardy, Principal Research Officer

Ms Celia Tancred, Principal Research Officer

Ms Chris Hall, Executive Assistant

Address

Senate Select Committee on Superannuation and Financial Services
Parliament House
Canberra ACT 2600

Tel: (02) 6277 3458
Fax: (02) 6277 3130
Email: super.sen@aph.gov.au
Internet: http://www.aph.gov.au/senate

TERMS OF REFERENCE

On 21 June 2000, the Senate agreed to refer the provisions of the New Business Tax System (Miscellaneous) Bill (No.2) 2000 to the Senate Select Committee on Superannuation and Financial Services for inquiry into the impact of certain aspects of the Bill on superannuation funds and report by 27 June 2000.

TABLE OF CONTENTS

MEMBERSHIP .... **iii**

TERMS OF REFERENCE .... **v**

REPORT ON THE PROVISIONS OF THE NEW BUSINESS TAX SYSTEM (MISCELLANEOUS) BILL (NO. 2) 2000 .... **1**

INTRODUCTION 1

Background to the inquiry *1*

Conduct of the inquiry *1*

Background to the Bill *1*

ISSUES 3

Implementation of Capital Gains Tax (CGT) measures *3*

Implementation of the requirement to segregate assets *5*

Implementation date *7*

Inconsistencies in Government policy objectives *8*

Need for overall review of superannuation *8*

Minister's response *9*

CONCLUSIONS AND RECOMMENDATION 9

LABOR SENATORS' REPORT **11**

Introduction *11*

Main concerns *11*

Possible solutions *14*

Conclusion *14*

Recommendation *15*

AUSTRALIAN DEMOCRATS REPORT **17**

APPENDIX 1 .... **19**

LIST OF SUBMISSIONS 19

APPENDIX 2 .... **21**

LIST OF WITNESSES 21

REPORT ON THE PROVISIONS OF THE NEW BUSINESS TAX SYSTEM (MISCELLANEOUS) BILL (NO. 2) 2000

INTRODUCTION

Background to the inquiry

1.1 The New Business Tax System (Miscellaneous) Bill (No. 2) 2000 ('the Bill') was introduced into the House of Representatives on 13 April 2000. The provisions of the Bill were referred to the Committee on 21 June 2000[1] for examination and report by 27 June 2000. The reference was the result of an amendment moved by Senator Lyn Allison, Australian Democrats, to a Selection of Bills Committee report.

1.2 In accordance with its terms of reference, the Committee was required to examine the impact of certain aspects of the Bill on superannuation funds.

Conduct of the inquiry

1.3 Although there was a very short time frame in which to conduct the inquiry, the Committee received a number of submissions from various organisations and individuals with a special interest in the issue. A list of the submissions received is at **Appendix 1.**

1.4 The Committee met in public to consider the provisions of the Bill on 26 June 2000. Senator the Hon Rod Kemp, the Assistant Treasurer, attended in charge of the Bill. A list of witnesses who gave evidence at the public hearing is at **Appendix 2**.

Background to the Bill

1.5 The Bill contains proposed amendments to the *Income Tax Assessment Act 1936* and the *Income Tax Assessment Act 1997* (ITAA) and covers a wide range of themes, including:

- scrip for scrip rollover relief;
- the taxation of life insurers;
- measures dealing with losses;
- measures dealing with the imputation system;
- other Capital Gains Tax (CGT) measures; and
- integrity measures.

1.6 The Committee did not consider the full range of measures contained in the Bill. Instead, in accordance with its terms of reference, the inquiry concentrated on those measures which impacted on superannuation funds, that is those measures contained in Schedule 2 of the Bill, which amends the ITAA 'to broadly tax the current pension business of superannuation funds consistently with that of life insurers'.

---

1 Selection of Bills Committee Report No 123 of 2000, dated 21 June 2000.

1.7 The objectives of these measures are to treat the pension business of superannuation funds consistent with the annuity business of life insurers and to remove the CGT anomalies from the taxation system.

1.8 The objectives are achieved by the requirement to identify and segregate specific assets for the payment of pensions. These assets must be managed separately from the balance of assets of a fund, must be subject to an annual valuation and maintained at the level of current pension liabilities. Where a valuation is less than the level of segregated pension assets a fund must transfer the excess from the pension assets to the balance of the fund. The transferred amount will be treated as assessable income of the fund.

Industry, media reaction

1.9 The proposed measure to impose CGT on conversion of superannuation assets attracted widespread comment in the media. A number of organisations, including the Association of Superannuation Funds of Australia (ASFA), CPA Australia, the Institute of Chartered Accountants in Australia (ICAA) and the Small Independent Superannuation Funds Association (SISFA) expressed dissatisfaction with the proposal.

1.10 ASFA, while agreeing with the principle underlying the measure, stated that, in its view, the application of capital gains tax on conversions in small funds was retrospective because taxpayers nearing retirement did not expect to be subject to the tax. It argued that the measure be phased in.[2]

1.11 CPA Australia argued that the proposal to tax asset conversions would conflict with the Government's aim of encouraging taxpayers to save for retirement.[3]

1.12 The ICAA said the proposals would undermine the reform process and SISFA forecast a 'demoralising' effect on smaller funds. In addition, the Australian Retirement Income Streams Association (ARISA) warned that the measures might affect the income of some retirees with existing retirement income products.[4]

1.13 Some of the reactions to the proposals were based on claims of retrospectivity and the alleged lack of time people had to make retirement decisions.

1.14 In addition, the Financial Planning Association (FPA) expressed its concern that many trustees of DIY funds holding assets acquired before 1985 (who believed that they would not be caught by the latest change) would in fact be affected because of changes made to tax rules in June 1988. The effect of the 1988 changes meant that all assets would be subject to capital gains tax on disposal.[5]

Government response

1.15 On 20 June 2000, the Assistant Treasurer, Senator the Hon Rod Kemp, announced that the Government would introduce amendments to the Bill 'to allow members of self

---

2 ASFA Media Release, 4 May 2000.

3 CPA Australia Media Release, 27 April 2000.

4 The Australian Financial Review, 2 May 2000, p. 7

5 Australian Financial Review, 29 May 2000, p. 47.

managed superannuation funds adequate time to adjust to the changes to the tax treatment of capital gains for complying superannuation funds when converting from the accumulation phase to the pension phase'. In his media release, the Assistant Treasurer announced:

> As a transitional arrangement, self managed superannuation funds and small APRA funds will be exempt from tax on capital gains accrued before 1 July 2000 on assets transferred from the accumulation phase to the pension phase prior to 1 July 2005. These funds will be taxed on the capital gain accruing between 1 July 2000 and the date the asset is transferred to the pension phase.
>
> These transitional arrangements will allow members of self managed funds who are close to retirement to continue with their current retirement plans and give sufficient time for others to adjust their retirement plans having regard to the new measures[6]

Industry reaction

1.16 In the media, a number of organisations, such as ASFA and CPA Australia, welcomed the Assistant Treasurer's announcement on removing retrospective elements and minimising the impact for those close to retirement. However, both ASFA and CPA Australia noted that there were still other areas of concern with other aspects of the Bill.

1.17 Notwithstanding the proposed amendments, from the evidence provided to the Committee, it appears that the main issues of concern for superannuation funds continue to be the implementation of the proposed Capital Gains Tax (CGT) measures and the proposals to segregate specific assets for the payment of pensions. These and other issues raised during the inquiry are discussed in the next section.

ISSUES

Implementation of Capital Gains Tax (CGT) measures

1.18 The effect of the 20 June amendments would be to defer the CGT provisions affecting small funds from 1 July 2000 to 1 July 2005, that is, anyone retiring before 1 July 2000 will have no CGT liability; those retiring between 1 July 2000 and 1 July 2005 would only pay CGT 'accrued' between those dates. Those retiring after 1 July 2005 would be taxed on capital gains on assets at the time that those assets are realised.

1.19 At the hearing, the Committee was advised by the ATO that the potential revenue for the CGT measure was estimated to be $70 million per annum.

1.20 Some groups, like ASFA and CPA Australia,[7] welcomed the amendments which provide transitional relief for self managed and small APRA funds. Others, like ARISA, SISFA and the IAA, submitted that, in the interests of equity, the transitional proposals in the amendments should not apply only to small funds, but should apply to all superannuation

---

6 Assistant Treasurer Media Release No. 028, 20 June 2000.

7 Submission No 9, and CPA Australia Media Release, 21 June 2000.

funds. Mrs Lesley Dewar, a Certified Financial Planner, submitted that, at the very least, the Bill should be amended to provide a transitional phase for all superannuation fund members.[8]

1.21 ARISA further submitted that the Bill be returned to its original form or that CGT for all super funds and life insurance companies be either removed or deferred.[9]

1.22 At the hearing, most witnesses, including CPA Australia, commented that the timeframe to implement the CGT measures was too tight and that it would be administratively difficult to comply in the period allowed.

1.23 Superannuation Australia also expressed its concerns about the impact of taxation provisions in the Bill, especially on small and self-managed funds. The corporation pointed to a number of problems with the proposed Bill and the proposed amendments. In calling for the Bill to be rejected, Superannuation Australia submitted that the measures contained in the Bill were retrospective and amounted to double taxation and that the proposal for taxing unrealised capital gains in superannuation funds, together with other CGT concessions available to small business taxpayers, have a negative effect on superannuation as a preferred investment vehicle for any growth assets.[10]

1.24 Both SISFA and Superannuation Australia submitted that the proposed changes are also counter to the concessions granted in SLAB 4, with Superannuation Australia pointing out that the proposals will severely disadvantage any taxpayer who chose to acquire up to 100 per cent of the member's business premises in their superannuation fund after 12 May 1998. The corporation noted that this 'begs the question of why anyone would want to contribute or acquire their business premises via a superannuation fund under the proposed rules.'[11]

1.25 CPA Australia, in evidence to the Committee, drew attention to a problem associated with the method of valuation of assets for capital gains purposes under the proposed legislation, which seemed to be at variance with the valuation method prescribed in the 1988 legislation. The CPAs indicated that, in their view, valuation of assets at 1 July 2000 should be based on the higher of cost or market value to ensure certainty and consistency of application with the 1988 changes.

1.26 The Financial Planning Association (FPA), while welcoming the broadening of the tax base, was not supportive of what it sees as a new tax on DIY funds. The Association advised that it felt that the long term effect of the tax would be to erode the assets available to a person in retirement.

Retrospectivity

1.27 A number of submissions were critical of the retrospective nature of aspects of the legislation. Given the Government's transitional measures will benefit those persons retiring before 1 July 2000, and, to a lesser extent those who retire before 1 July 2005, groups like

8 Submission No 11.

9 Submission No 5, p. 1.

10 Submission No 7, pp. 2-4.

11 Submission No 7, p. 3.

Superannuation Australia pointed out that other fund members remain adversely affected because they are still in the accumulation stage.[12]

1.28 The Institute of Chartered Accountants were also opposed to what it regarded as the retrospective nature of the changes. The Institute suggested that those who seek to retire and take their benefits as an income stream in the next five years will have made decisions based on the present legislation.[13]

Implementation of the requirement to segregate assets

1.29 Under the current legislation, superannuation funds have a choice on how to obtain tax exemption on the earnings from current pension assets – either segregation of assets or apportionment of income and gains. The measures proposed in the Bill remove this choice and require the segregation approach in order to remove tax minimization opportunities. The Committee understands that this measure in the Bill arose from concerns that life companies were over-estimating the assets and income attributable to current pension business.

1.30 The Committee notes that most funds, including industry, corporate and some public sector funds do not use the segregation method because it imposes a relatively significant cost and administrative burden to those funds which have a relatively small number of pensions. Without some amendments, corporate funds and some industry funds (including those that have developed the product) see the proposals as a disincentive to their providing allocated pensions in the long run.

1.31 The majority of evidence to the inquiry suggests that the requirement for those funds to use the segregation approach could have the potential to make the measures unworkable to the extent that some will forego claiming the exemption, because the costs of complying with the provisions will exceed the value of any tax concession. Concern over the additional administrative costs associated with the requirement to identify and segregate specific assets for the payment of pensions was expressed by such groups as ASFA, the Corporate Super Association, SISFA, the Institute of Chartered Accountants and the Institute of Actuaries.[14]

1.32 Some submissions were critical of the impact of the proposed measures on corporate funds. For example, the Corporate Super Association described the proposal to treat not-for-profit corporate super funds as commercially driven life offices as 'illogical, unconscionable and unworkable'.[15] The Association submitted that, because of the increased costs associated with implementation of the proposed measures, corporate super funds may have to cease providing pensions and that, in the meantime, the introduction of allocated pensions has been put on hold by member funds. At the hearing the CSA advised that a potential unforeseen consequence of this is that there may be an increased trend for people to take their superannuation as a lump sum payment.

1.33 The CSA further submitted that the vast majority of corporate funds would be 'squeezed out' of providing pensions, while life offices would be provided with a 'wonderful

12 Submission No 7, p. 5.

13 Submission No 4, p. 2.

14 Submission Nos 9, 2, 10, 4, 6 and 13.

15 Submission No 2, p. 2.

windfall of increased business and increased profits in a closed market'. This, the Association claims is not 'competition neutrality'.[16] The Association recommended applying the segregation requirement in the Bill to life offices, and maintaining the option for all stand alone funds (which would include most industry as well as major corporate super funds) to continue using the apportionment method.

1.34 At the hearing Superannuation Australia also endorsed the proportional exemption method, rather than the segregation method which it considers is not appropriate for small funds.

1.35 The Meat Industry Employees Superannuation Fund, an industry fund, claimed that segregation of assets would impose a significant burden on the fund with no additional benefit to either the Government or the members.[17]

1.36 William M Mercer submitted that a number of taxation anomalies had been introduced by the Bill; that the wording of the Bill is extremely complex, and in many cases 'extraordinarily difficult to interpret'; and that the changes in the tax treatment of pensions will, in some cases result in higher tax than would have applied if no concessions were provided.[18] William M Mercer was also critical of the administrative complexities, the high cost of compliance, and the unreasonably short implementation period;[19]

1.37 The ARISA, while generally supportive of the proposed measures, was one of a number of groups which submitted that the provisions of the Bill will result in an additional layer of administrative complexity for trustees of all superannuation funds.[20]

1.38 The Institute of Chartered Accountants expressed its concern that the proposed provisions favoured large public offer funds over corporate funds and funds with less than five members.[21]

1.39 Some evidence to the inquiry also suggested that the application of the segregation requirements would make it difficult, in many cases impossible, to replicate member investment choices.[22]

1.40 The Institute of Actuaries claimed that the proposal to require segregation of assets was not mentioned in the tax reform proposals in 1998 or in the Ralph Report and Government response in 1999, and that it was only in April 2000, when the Bill was tabled, that industry became aware of the proposal.[23] At the hearing a number of other witnesses, including SISFA and ASFA, also pointed out that in their view, notice of the proposed changes was not 'flagged' in the Ralph Report or the Government Response.

---

16 Submission No 2, p. 3.

17 Submission No 8, p. 1.

18 Submission No 3, pp. 1-4.

19 Submission No 3, p. 1.

20 Submission No 5, p. 4.

21 Submission No 13, p. 1.

22 Submission No 4, p. 2, and Submission No 1, p. 1.

23 Submission No 6, p. 2.

1.41 However, at the hearing, ARISA advised that it was aware from the Ralph Report and other Government statements, that superannuation fund taxation would alter in line with the taxation changes to life insurance companies.

Implementation date

1.42 A number of submissions drew attention to the length of the implementation period. For example, William M Mercer submitted that the Bill was introduced on 13 April, less than three months before its effective date, and that this is 'far too short a period to come to terms with highly complex, often ambiguous and unclear legislation'; further, that 'funds will be required to make hasty decisions on crucial aspects.'[24]

1.43 ASFA submitted that, in relation to the segregation of assets, because of the inadequate time for preparation and insufficient guidance from the ATO, uncertainty was a big issue. At the hearing, FPA also advised that feedback from its clients suggested that the uncertainties surrounding the issues were eroding investor confidence in the superannuation system.

1.44 The Committee notes that the proposed legislation allows for a 90-day period for funds to comply and that the Taxation Commissioner has discretion to extend the 90 day period in certain circumstances.

1.45 The majority of evidence to the Committee was supportive of deferring the operation of the Bill for 12 months to 1 July 2001. This view was presented by such organisations as ASFA, Corporate Super Association, William M Mercer, the Institute of Actuaries (IAA) and the Institute of Chartered Accountants. Individuals such as Mr Ross Stephens of KPMG also expressed support for this approach. [25]

1.46 Those seeking to have the implementation of the Bill deferred submitted that this would allow time for more detailed consultation on all aspects of the superannuation measures contained in the Bill;[26] others, like the IAA urged deferral so that the concerns raised could be addressed and consideration be given to simplifying some of the more complex aspects of the Bill.[27]

1.47 A number of alternative methods to achieving the Government's objectives were submitted by groups such as the IAA, ARISA, William M Mercer, Mr Ross Stephens of KPMG and others.

1.48 Some submitted that, in their view, whether a segregated approach or an alternative approach is used, it would have little or no impact on revenue. For example, William M Mercer submitted that its alternative approaches would result in significant administrative savings and effectively remove the current tax minimization options without any real impact on tax revenue.[28] The IAA indicated that such a deferral would result in very little revenue

---

24 Submission No 3, p. 4.

25 Submission No 1, p. 6.

26 Submission No 14, p. 2.

27 Submission No 6, p. 2.

28 Submission No 3, p. 4.

loss.[29] ASFA, too, in recommending that any provisions relating to funds other than self-managed funds and life companies not take effect until 1 July 2001, pointed out that the costs to revenue of such a change would be minimal.[30] Mr Ross Stephens, KPMG, also considered that if his proposed solutions were implemented, it would involve no cost to revenue.[31]

Inconsistencies in Government policy objectives

1.49 A number of submissions, such as those from IAA, ICAA and KPMG, claimed that the impact of the proposed measures for superannuation would discourage funds, especially corporate funds, from offering pension options and that this is contrary to Government policy to encourage retirement income streams.[32]

1.50 Others, like SISFA and the Bramex Superannuation Fund, submitted that there are difficulties in reconciling the Government's policy framework for superannuation with its policy framework for the New Tax System.[33] According to these organisations, the proposed arrangements are actually a new tax or at least an extension of an old tax. Bramex Superannuation Fund also claimed that, in its view, the complex and inequitable proposals actually threw up new inequities and suggested that the new tax should be withdrawn completely.[34]

1.51 William M Mercer also drew attention to an apparent inconsistency between the measures in the Bill restricting the amount of assets that can be treated as backing pension liabilities and the 1999 changes to the *Superannuation Industry (Supervision) Act 1993* (SIS) regulations.[35]

Need for overall review of superannuation

1.52 A number of organisations submitted that it was not appropriate to consider such an ad hoc approach to the complex issues associated with superannuation and taxation at this time. For example, the Institute of Chartered Accountants in Australia advised that 'the implementation of ad hoc unannounced changes further confuses superannuation contributors and increases uncertainty'.[36] The ARISA submitted that 'significant changes should not be made in a piecemeal fashion, and should be dealt with as part of a comprehensive retirement income policy.'[37] Both organisations indicated their support for a full review of superannuation, as foreshadowed by the Treasurer, with ARISA adding that there also needs to be better integration between the superannuation, tax and social security systems and that

---

29 Submission No 6, p. 2.

30 Submission No 9, p. 2.

31 Submission No 14, p. 1.

32 For example, Submission No 6, p. 1, Submission No 13, p. 1 and Submission No 1, p. 1.

33 Submission No 12, p. 2.

34 Submission No 12, p. 3.

35 Submission No 3, p. 6.

36 Submission No 4, p. 1.

37 Submission No 5, p. 2.

there should be consistency in the regulatory treatment between different superannuation and retirement income stream products.[38]

1.53 Both ASFA and Superannuation Australia also called for a complete review of the taxing of superannuation funds;[39] with ASFA advising that, in its view, while there are some inconsistencies in the 1988 legislation which may need to be fixed, the proposed legislation adds yet more complexity and appears to be 'bad legislation trying to make it line up with other bad legislation'. SISFA submitted that it would be simpler to withdraw the superannuation measures from the Bill and wait for overall reform.

Minister's response

1.54 At the public hearing the Minister noted the concerns raised by industry regarding the proposed requirement to segregate assets. The Minister advised that the Government is continuing to consult with industry on this complex issue and 'hopes to be in a position to make an announcement shortly which will address those concerns'. The Minister advised that the Government may consider an optional arrangement in respect of segregation in some circumstances. The Minister advised that the Government would welcome industry working with it to develop 'a sensible solution to this issue' and that it is anticipating a quick outcome.

1.55 In relation to the CGT issue, the Minister noted that the object of the measure was to remove a CGT anomaly from the tax system. He noted that members of complying funds would benefit from a number of other rebates and concessions under the New Business Tax System. He said that Daryl Dixon, an independent financial consultant, had expressed the view that 'this additional tax bill is a very small price to pay for DIY and other funds to gain access to the new allocated pension tax regime'.

1.56 The Minister also pointed out that the Government was aware of calls to have aspects of the Bill which impact on superannuation funds delayed, but that, in the view of the Government, this would not only have a significant impact on revenue, but would also create great uncertainty.

CONCLUSIONS AND RECOMMENDATION

1.57 The Committee notes that there are some concerns with the measures relating to superannuation contained in both the Bill and the proposed amendments. The concerns relate to the implementation of the proposed measures.

1.58 Some evidence suggests that there are a number of taxation anomalies which need to be further addressed, including the retrospective nature and administrative complexities of the proposed CGT measures, and that there is a need to reconsider the application of the requirement to identify and segregate specific assets for the payment of pensions, as the additional administrative costs are likely to cause major problems for some funds.

---

38 Submission No 5, p. 1.

39 Submission No 7, p. 5.

1.59 The Committee is also mindful of the calls for consistency in Government policy objectives and the need for an overall review of superannuation and related taxation and social security legislation.

1.60 Noting that some have called for the Bill to be rejected, the Committee also notes that others favour deferral to allow time for the concerns and unresolved issues raised during this inquiry to be addressed, while others call for the Bill to be progressed.

1.61 The Committee notes that the Minister has indicated his intention to continue consultations with industry in an attempt to find a solution to the complex problems associated with the requirement to segregate assets and the method of valuing assets for CGT purposes (which appear to be out of step with the 1988 legislation) and that he intends to make an announcement shortly.

1.62 The Committee notes that it appears that a number of issues canvassed during the inquiry may not have been raised with the Minister. Given that these concerns are central to the subject of the Committee's inquiry, the Committee encourages interested parties to work with the Government to develop a sensible solution to these issues.

1.63 The Committee notes the Minister's concern that any delay in the passage of the Bill would have a significant impact on revenue and would also create greater uncertainty in the industry. The Committee is also concerned about the potential impact on revenue and is conscious of the Government's legislation program, given that there are only three sitting days left in this sitting. The Committee notes that a small number of groups have systems in place to enable them to cope with the implementation of the proposed measures from 1 July 2000, any further delays would only increase uncertainty which would not be in the best interests of those in the retirement income market.

1.64 The Committee notes that, while the implementation date is from 1 July 2000, the proposed legislation allows for a 90-day period for funds to comply and that the Taxation Commissioner has discretion to extend the 90 day period in certain circumstances.

1.65 The Committee recommends that the Bill be agreed to.

Senator John Watson
Committee Chair

LABOR SENATORS' REPORT

Introduction

1.1 Labor Senators wish to thank those organisations and persons who made a submission to and/or appeared before the Committee on the *New Business Tax System (Miscellaneous) Bill (No. 2) 2000* at such short notice. The submissions and evidence were of a very high standard and the speed with which the submissions were prepared reflect an industry-wide concern for the provisions of this bill that the Committee examined. Labor Senators wish to briefly outline some of those concerns.

Main concerns

Increased revenue

1.2 Under questioning before the Committee, Treasury admitted that the Capital Gains Tax (CGT) provisions in the bill are expected to raise $70 million per year. This hitherto unknown figure effectively results in $70 million per year being ripped out of superannuation funds right around Australia. That is, Australian pensioners and annuitants will be $70 million worse off as a result of these CGT changes. Note that the changes will affect some people more than others. Those that it affects may be significantly affected.

1.3 Labor Senators asked the Government to supply any modelling that was done on this policy initiative (assuming that some modelling was done to calculate the $70 million per year revenue estimate provided by Treasury). Senator Sherry also requested modelling that may have been done on the net impact on superannuation funds resulting from the full range of measures in this bill and the longer term impact on retirement incomes and Government outlays. Labor Senators hope that this modelling will be provided to the Committee or the Senate prior to debating this bill in the Senate.

Increased complexity

1.4 All witnesses before the Committee highlighted that the provisions in this bill that require superannuation funds and life offices to value assets at 1 July 2000 and segregate those assets relating to the payment of pensions will greatly increase the complexity of superannuation.

Increased compliance costs

1.5 All witnesses also acknowledged that there was "no doubt" this bill will significantly increase compliance costs for superannuation funds and life offices. Mr Michael Lorimer, Director and Chairman Policy Development Committee of the Small Independent Superannuation Funds Association (SISFA), stated that the current $2000-2500 cost his company, Managed Superannuation, charges for compliance could be expected to double to at least $4000 as a result of this bill. Greater compliance costs must result in lower retirement incomes.

Applying a retrospective CGT

1.6 Almost all of the witnesses before the Committee stated that this bill is applying a retrospective CGT going back to July 1988. The retrospective CGT goes back to the time of

purchase of an asset. This could be before July 1988. Mr Tony Negline, Chairman, Australian Retirement Incomes Streams Association, said that where a fund did not transfer assets and commence a pension before the 1 July 2005 deferment date, the CGT liability would apply to capital gains made from the purchase price, even if that was before CGT first applied prospectively from September 1985.

1.7 The requirement to value assets from 1 July 2000 may mean that some assets could be valued at less than their purchase cost. If an asset is subsequently sold CGT may be due despite the fact that the asset has been sold for less than it was purchased for.

1.8 The Prime Minister was highly critical of Labor's 1998 election policy to prospectively from 1 July 2000 include capital gains made on pre-September 1985 assets within the CGT provisions, stating that "…this change is going to strike at the heart of the retirement security of many older Australians." As many witnesses to the Committee stated, this bill specifically applies a retrospective CGT to assets that thousands of Australians believed would be free of CGT. In effect, the Prime Minister's own legislation strikes at the heart of the retirement security of many older Australians.

1.9 In some cases, the family home could be subject to CGT. The amendments in *Superannuation Legislation Amendment Act No.4* allow – and the Government promoted this as a positive change – superannuation funds to invest up to 100 per cent of fund assets in real business property. Superannuation funds may include the family home where it is on a primary producing property that is the property of the fund. This property could now be subject to CGT where the superannuation fund transfers the assets to pay a pension from the fund, resulting in CGT effectively being paid on the family home.

1.10 The Government's solution to provide a transitional provision for funds that transfer assets before 1 July 2005 does not address the problem of retrospective CGT treatment. To grant an exemption to some fund members, but not to others is not equitable.

Lower retirement incomes, pensions and annuities

1.11 The Government admitted, for the first time, that the provisions of this bill relating to the CGT of superannuation funds and life offices will result in a $70 million additional revenue windfall to the Government. This $70 million does not include the additional cost of compliance to superannuation funds and can only come from either higher fees and charges, more tax from members' superannuation accounts and will result in lower pensions, annuities and lump sums. In the case of some employer-sponsored corporate funds, it will require additional employer contributions to maintain pension benefit levels. In that case, it is a tax on employers.

Inconsistency between funds

1.12 The amendments made by the Government to defer the CGT provisions for small APRA regulated funds and self-managed funds until 1 July 2005 results in inconsistent treatment between funds. This has the effect of distorting the tax treatment of similar economic entities, something which is contrary to the recommendations and principles undermining the Financial System Inquiry, the Review of Business Taxation and the Government's response to the RBT. It also potentially gives one sector of the market an advantage over another. All witnesses opposed the inconsistent treatment of similar entities.

1.13 The inconsistencies and general impact of this bill were highlighted by the submission and evidence of the Corporate Super Association, which stated that the administrative complexities and cost increases that this bill introduces could force many company superannuation funds to close and no longer provide superannuation benefits for their members.

Timing

1.14 With few exceptions, witnesses were disappointed by the lack of consultation and little time allowed for proper debate and consideration of this bill. Many attributed the anomalies and inconsistencies of the bill to the little time provided to carefully consider not only the specific provisions of the bill but also its impact on public policy in general. Ms Barbara Smith, Technical Director, Superannuation Australia, was particularly concerned about the lack of time provided to debate this bill and lack of consultation. While ASFA and ARISA indicated they had been consulted on the provisions of this bill, even they had concerns with the bill as drafted. It is difficult for the Senate to make an informed decision on this bill with so little time provided to consider and debate the issues.

Government to consider further changes

1.15 Senator Kemp indicated that he was willing to discuss with the industry and consider implementing other methods that may alleviate some of the complexity of the bill. Senator Kemp said that he was aware of the problems that had been raised, that he hoped to work out a solution and that it was a complex issue.

1.16 Labor Senators welcome this invitation from Senator Kemp. However, in admitting that this bill could be changed in the future, Senator Kemp is asking the Senate to pass what is, by his own admission, a flawed bill. He is asking the Senate to take on trust that he will fix any issues that arise after the bill has passed and after further discussion with the industry. Given the obvious opposition to the provisions of this bill and the short time frame for the Senate to consider it, Senator Kemp's position is understandable but not helpful to the Senate.

1.17 The Government also claimed that superannuation funds will have 90 days to segregate assets from the 1st of July. The Government's indication that it will review elements of the Bill leaves superannuation funds uncertain as to whether they should begin segregating assets and also valuing assets. It must be remembered that there are significant costs to superannuation funds in undertaking both property valuations and asset segregation.

Not part of the Review of Business Taxation

1.18 Of the witnesses before the Committee, only one was able to identify where this provision may have been discussed in the Review of Business Taxation. Mr Negline from ARISA broadly identified a possible reference in the RBT although other witnesses argued strongly that this measure was not anywhere to be found in the RBT. Significantly, the Treasury could not identify a specific reference to this CGT measure in the RBT arguing that the 15 per cent tax underlying pensions and annuities indicated such a provision would be forthcoming. Labor Senators do not see the link between those announcements and the introduction of a retrospective CGT on pensions and annuities.

Impact on Small Businesses

1.19 Senator Watson, the Chair of the Committee, raised with the Treasury and some other witnesses that this bill actually works contrary to the Government's oft promoted CGT exemptions provided to small business.

1.20 Senator Watson argued that small businesses that, after the passage of *SLAA 4* moved assets into a superannuation fund, would be disadvantaged compared to those who did not move assets into a superannuation fund and held assets individually. This is because an individual small business tax- payer can take advantage of either a 15 year ownership CGT exemption or the $500,000 CGT roll-over exemption for small businesses that use the sale of their business to retire. Senator Watson's view was supported by Mr Peter McDonald, National Director, Superannuation Australia, and was not opposed or refuted by Senator Kemp when put to him by Senator Watson.

Inconsistency with retirement incomes policy

1.21 The bill removes encouragement for retirees to take income streams as opposed to lump sums. Mr Nicholas Brookes, Secretary, Corporate Super Association, stated that the bill provided an impetus not to take pensions and encourages the 600,000 retirees in corporate superannuation funds to "take the cash and run."

1.22 Labor Senators consider that Government policy should encourage superannuation fund members, particularly members of corporate and industry superannuation funds, to stay in their fund and roll-over into an income stream product. Industry funds and corporate funds often provide low or no cost pensions or pension products to fund members, and this bill could result in those products being withdrawn, to the detriment of ordinary fund members and their retirement incomes.

Possible solutions

1.23 Only one of the witnesses supported the passage of the provisions examined by the Committee. Possible solutions were proposed by Mr Stephens of KPMG and supported by the Corporate Super Association. Possible amendments were also proposed by the ARISA and some other witnesses. Most witnesses, however, argued that the bill should not be passed in its current form.

1.24 Labor Senators consider that to amend this bill in an ad hoc way may only serve to complicate the taxation of superannuation further than it already is. This matter is best considered in a comprehensive review of retirement incomes policy. Labor has already committed itself to conducting a review of retirement incomes policy and has indicated that a properly resourced Senate Select Committee on Superannuation and Financial Services would be the best forum for conducting this review.

Conclusion

1.25 Labor broadly supports the bill before the Committee. However, it is clear from evidence provided to the Committee, especially from the Government's evidence, that this bill will introduce significant complexities and increase compliance costs to superannuation funds and life insurance offices. This is in direct contradiction of the Treasurer's recent press club announcement where he committed his Government to undertaking a review of superannuation in an effort to simplify its operation.

1.26 In addition, the bill and the recent amendments to the bill introduce inconsistencies which go against the principles of the Financial Sector Inquiry, the Review of Business Taxation and the Government's response to the FSI. The bill is also inconsistent with the Government's stated retirement incomes policy to encourage self-provision in retirement and income streams.

1.27 The Government has indicated a willingness to discuss suitable industry wide solutions that will avoid some of the complexities and difficulties this bill causes superannuation funds. Labor Senators welcome this commitment from Senator Kemp. However, for certainty and to avoid unnecessary costs, Labor Senators do not see value in passing legislation that the Government admits will require further amendment.

Recommendation

1.28 Labor Senators recommend that the bill be passed but that the Government excise the provisions examined by the committee relating to the taxation of superannuation funds.

1.29 The excised provisions should be subject to consultation between the Government, industry and other people affected, as Senator Kemp offered to do in evidence to the Committee, to sort out the complexity and difficulties identified in most of the submissions to the Committee. Labor Senators recommend that, upon industry agreement to suitable changes, legislation be drafted which will provide certainty to Australian superannuants, retirees and pensioners.

Senator the Hon Nick Sherry **Senator Stephen Conroy** **Senator John Hogg**

AUSTRALIAN DEMOCRATS REPORT

1.1 The Government and Labor senators' reports outline in some detail the objectives of this bill and the key problems with it.

1.2 On the one hand, we are faced with a bill that is supposedly part of the Ralph Business Tax reforms but is not mentioned anywhere in it, and industry clearly has not been adequately consulted on the bill – a point acknowledged by the Minister.

1.3 On the other hand, the Government estimates that this bill will raise $70 million by closing down a tax advantage perceived to be held by smaller super funds not available to larger super funds on the transfer of funds from accumulation to pension stream funding.

1.4 What is also clear is that this bill deals with issues of immense complexity, potentially greatly increases compliance costs and appears to catch in its wake many larger super funds which were not intended to be caught by it, if the Government's objective is to be believed.

1.5 The Democrats are particularly concerned that the bill has the potential to adversely affect larger corporate and industry superannuation funds, and could potentially make pensions less attractive as a superannuation option.

1.6 Having said that, the Democrats are aware that some operators will use superannuation tax concessions however they can to obtain a maximum tax benefit, thereby reducing revenue collections. The revenue does need to be protected.

1.7 This is the latest in a number of measures directed by the Government against small DIY funds. This has been a growing sector of the market, and also a very lucrative one. Whether the growth in this sector is driven because of better returns or because of tax planning is a fundamental policy issue. A clearer policy statement of the Government's attitude to the DIY sector is clearly needed, and considering legislation of this type is difficult in the absence of a policy direction.

1.8 The Democrats believe it will be extremely difficult between now and the end of the week for the Senate to draft appropriate amendments to achieve the Government's objective while meeting the industry objective of minimising compliance costs and ensuring that pensions remain an attractive objective for corporate and industry super funds.

1.9 Given this difficulty, we are inclined towards excising the provisions of the legislation, but with the Government issuing a statement as to what the clear policy intent will be, in particular:

- Exactly what is the perceived tax advantage for smaller funds that it is seeking to be removed;

- The desirability of minimising compliance costs (a number of alternative approaches to strict segregation of assets were presented to the Committee which should be considered to achieve this);

- A determination that the measure not apply to larger super funds;

- A determination that genuine pension allocation will be advantaged in tax law provided tax planning opportunities are dealt with;

- An operative date that is as early as possible to protect the revenue, but allows for adequate notice to the industry – particularly the DIY sector – on what is likely to happen.

1.10 With a clear statement of policy, appropriate legalisations should then be drafted to achieve this policy in close consultation with industry.

1.11 The Democrats would be prepared to support the earliest practicable operative date for such legislation if industry is clearly notified of the policy intent of Government and has some clear guidance on what direction to take in planning for such change.

Senator Lyn Allison

APPENDIX 1

LIST OF SUBMISSIONS

1. Mr Ross Stephens, KPMG
2. Corporate Super Association
3. William M Mercer P/L
4. The Institute of Chartered Accountants in Australia
5. Australian Retirement Income Streams Association Ltd
6. Institute of Actuaries of Australia
7. Superannuation Australia P/L
8. Meat Industry Employees Superannuation Fund P/L
9. Association of Superannuation Funds of Australia Ltd
10. Small Independent Superannuation Funds Association
11. Mrs Lesley Dewar, Certified Financial Planner
12. Trustee of Bramex Superannuation Fund
13. The Institute of Chartered Accountants in Australia (supplementary)
14. Mr Ross Stephens, KPMG (supplementary)
15. The ASN Group P/L

APPENDIX 2

LIST OF WITNESSES

Monday, 26 June 2000, Canberra

CPA Australia
Mr Murray Wyatt, Chair Centre of Excellence
Mr Brad Pragnell, Superannuation Policy Adviser

Corporate Super Association
Mr Nicholas Brookes, Secretary

Small Independent Superannuation Funds Association
Mr Graeme McDougall, Chief Executive Officer
Mr Michael Lorimer, Director and Chairman, Policy Development Committee

Bramex Superannuation Fund
Mr Ross Ramsey, Trustee

Senator the Hon Rod Kemp, Assistant Treasurer
Accompanied by an official from the Australian Taxation Office:
Mr Tony Regan, Assistant Commissioner, Large Business and International Division, ATO

Australian Retirement Income Streams Association
Mr Tony Negline, Chairman

Association of Superannuation Funds of Australia
Dr Michaela Anderson, Director, Policy and Research

Financial Planning Association
Mr Tim Gunning, Chair, Superannuation Committee

Superannuation Australia Pty Ltd (teleconference)
Mr Peter McDonald, National Director
Ms Barbara Smith, Technical Director