Office of the Chief Executive
Geoff Rankin, FCPA

CPA Australia
ABN 64 008 392 452

CPA Centre
Level 28, 385 Bourke Street
Melbourne VIC 3000 Australia
GPO Box 2820AA
Melbourne VIC 3001 Australia

T +61 3 9606 9689
F +61 3 9602 1163
W www.cpaaustralia.com.au
E geoff.rankin@cpaaustralia.com.au

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General Manager
Superannuation, Retirement and Savings Division
The Treasury
Langton Crescent
PARKES ACT 2600

E-mail: simplersuper@treasury.gov.au

Dear Mr Lonsdale

A plan to simplify and streamline superannuation

CPA Australia welcomes the opportunity to provide comment on the Government's plan to simplify and streamline superannuation.

CPA Australia has been a long time advocate for the simplification of superannuation and we welcome and support the overall proposal. We believe these changes will significantly simplify Australia's superannuation system and help improve the retirement savings of many Australians.

Please find attached our submission in response to the plan for your consideration. Our submission comprises general comments, proposals to minimise any disruption the transitional arrangements may have on the existing retirement plans of older Australians and identifies a number of issues that require clarification in order to fully understand the impact of the proposed changes. We make the following key suggestions in our submission:

- The commencement of the limit on undeducted contributions be deferred until at least 31 December 2006 to allow imminent retirees sufficient time to finalise retirement strategies that may have already commenced;
- Averaging of the limit on undeducted contributions be allowed over five years;
- The transitional limit on deductible contributions for individuals aged 50 and over be maintained at $100,000 for 10 years. Averaging of the $50,000 limit be permitted over five years;
- All death benefits paid from 1 July 2007 be tax free to minimise any arbitrage opportunities arising from the ability to encash and transfer superannuation benefits to adult children before death;

- The limit on employer ETPs be based on a flat dollar amount for each year of service to better recognise the distinction between genuine redundancy payments and “golden handshakes”; and

- The taxation of untaxed schemes be modified by removing the $700,000 limit in order that parity between members of untaxed schemes and taxed funds is maintained with the only difference being a higher rate of tax to compensate for contributions tax foregone.

We continue to analyse the plan and its impact and it is likely we will make a further submission at a later time.

We look forward to the opportunity to work closely with Government to ensure details of the proposed changes are finalised quickly and implemented efficiently and fairly to ensure existing retirement plans are not disadvantaged and the benefits of these changes are fully realised.

Should you have any queries or require further information please contact CPA Australia’s superannuation policy adviser, Michael Davison, on 02 6267 8552 or by email at michael.davison@cpaaustralia.com.au.

Yours sincerely

Geoff Rankin FCPA
Chief Executive Officer

cc M Davison

CPA Australia

Submission on a plan to simplify and streamline superannuation

General Comment

Having been a long time advocate for the simplification of superannuation, CPA Australia welcomes and supports the overall proposal. We believe these changes will significantly simplify Australia's superannuation system and help improve the retirement savings of many Australians.

The announcement of the proposed changes on Budget night, 9 May 2006, with a commencement date of 1 July 2007 has the potential to significantly disrupt or alter the retirement plans of many Australians, either in the middle of implementing their plans or planning to retire in the next couple of years. As the proposal is only that and not confirmed in law, imminent retirees are unable to finalise their retirement plans and financial planners are unable to provide advice to their clients on their retirement options. For this reason, it is imperative details of the plan are confirmed and finalised as soon as possible and amending legislation is introduced quickly once the consultation process is completed.

For similar reasons, any transitional arrangements put in place must ensure individuals in the process of implementing retirement plans are not penalised by law changes when they were acting in good faith under the laws of the day. An example is someone in the process on making a large undeducted contribution following the sale of a property being unable to finalise the transaction due to the limit imposed on undeducted contributions from Budget night. These issues are explored in more detail later in our submission.

Following are our specific comments on the detailed outline of the Plan.

ETP components

Section 2.3.1 of the Plan states all funds will be required to calculate a pre-July 1983 amount as at a particular date under the current rules. To provide people with sufficient time to transfer or consolidate their superannuation benefits to ensure their eligible service period is correctly reflected, we suggest this date is no earlier than 1 July 2007.

It is proposed that all current ETP components will form part of either the new exempt or taxable components. We seek clarification of whether it will be a requirement that benefits paid after 30 June 2007 be apportioned between the exempt and taxable components.

Death benefits

It is proposed that the payment of death benefits to dependants will be tax free, while the taxable component of death benefits paid to non-dependants will be taxed at 15%. We believe this will provide arbitrage opportunities and create inequities within the system. For example, an individual knowing they are going to die will be able to take their superannuation benefit as a lump sum and pass it on to their adult children tax-free. On the other hand, where death is sudden and not foreseen, the benefit would still be paid to the adult children but taxed at 15%.

As this arbitrage is unavoidable, and in keeping with the objective of retirees having much more flexibility over how their superannuation is spent, we suggest all death benefits are paid tax free, not just those to dependants.

To further remove the incentive for this arbitrage we also suggest the inconsistencies that exist between the definitions of dependant in the SIS Act and the Income Tax Assessment Act 1936 be removed by aligning the definition of child in the ITAA 1936 with that in the SIS Act.

With the removal of benefits tax, and consequently the pension rebate for over 60s we seek clarification of the impact on “anti detriment” payments. Will there continue to be the potential for funds to claim a tax deduction for “anti detriment” payments on death under section 279D of the ITAA 1936?

Invalidity payments

With the proposed changes we seek clarification on the future treatment of benefits paid due to invalidity.

Now that pensions will be tax free for recipients 60 and over, how will pensions paid on disability be taxed, particularly for recipients under age 60? Would they be taxed as for a recipient aged 55 to 59 but with the 15% pension rebate irrespective of age, or will they be tax free?

Also, will a post-June 1994 invalidity component continue to be calculated for permanent disablement and then form part of the exempt component, or will this concessional treatment no longer be available?

Complying pensions

The simplification of the pension rules will result in complying income streams – lifetime, life expectancy and market linked – essentially being redundant (except for current recipients wishing to preserve their 100% or 50% asset test exemption). As one of the objectives of the proposed changes is to provide retirees with the flexibility to decide when and how they access their superannuation, we suggest the pension and annuity standards be amended from 20 September 2007 to remove the commutation restrictions for existing complying income streams.

Compulsory cashing

While many imminent retirees may be inconvenienced by having their retirement plans put on hold until the changes come into effect on 1 July 2007, they will not necessarily be disadvantaged if they are able to defer their plans until after then. However, there may be individuals who will be disadvantaged by the compulsory cashing rules between now and 30 June 2007.

Anyone who turns 65 and is not working, ceases work after age 65, even if through no decision of their own, or turns 75 will be required to access their superannuation, either as a lump sum or at least as an income stream. While they could commence a minimum allocated pension in the interim to minimise the tax impact they would have otherwise avoided after 30 June 2007, there will be additional costs and inconvenience in doing so. While the long term benefit of the proposed changes will be greater simplicity, the short term impact on this group will be additional complexity.

Given compulsory cashing is proposed to be abolished from 1 July 2007, we suggest that date is brought forward to 9 May 2006 to ensure this group is not disadvantaged in comparison to their peers who are not forced to prematurely access their superannuation. We believe the risk to revenue of such a measure would be minimal as would be the risk of any mischief occurring.

The other group that may be disadvantaged by the compulsory cashing rules will be the recipients of death benefits as they too will miss out on the benefits they could have gained if they were able to defer payment until after 30 June 2007. To minimise the impact, we suggest a modification of the SIS Regulations to permit voluntary cashing of death benefits during the transitional period before 1 July 2007. From this date, compulsory cashing should again apply to death benefits.

Contribution rules

The proposed removal of the compulsory cashing restrictions for over 65s will provide retirees with a lot more flexibility over how and when they take their superannuation benefits as well as considerably reducing complexity. However, an additional layer of complexity and lack of flexibility will continue to exist with the work test for contributions after age 65.

Has consideration been given to removing the employment link for contributions after age 65? Such a move would be in keeping with the spirit of the proposed changes and would give retirees much more flexibility to move in and out of the superannuation environment as their needs change. It would also alleviate some of the impact the new contribution limits will have on imminent retirees who may have been planning on making larger contributions closer to retirement as they would then be able to spread annual contributions over a longer period without hitting an artificial barrier at age 65. Conversely, the annual limits would still restrict the amount that could be put into the system and minimise abuse.

Spouse rebate

With the change to the deductibility of contributions, we seek confirmation that the spouse contribution rebate will continue to be provided.

Deductible contributions

While the new limits on deductible contributions will provide greater flexibility for younger contributors, and we support them, they may disadvantage older contributors in the short term. Many people have significant financial commitments, such as family, education and mortgages, well into their late 40s and early 50s and as such have planned on making large superannuation contributions closer to retirement to catch up, as permitted by the current rules. This situation has been recognised and is reflected in the five year transitional period proposed. However, we believe these arrangements are still too restrictive and unfairly penalise people who may have retirement savings plans in place based on the current rules. For someone aged 50 their options have been reduced from $100,587 (plus indexing) a year for 15 years to only $100,000 a year for five years. Their potential retirement savings have dropped considerably.

We recommend the transitional limit for individuals aged 50 and over be maintained at $100,000 for 10 years. This would permit more people, especially those in the over 50 group, who could have contributed the higher amount and had planned to, to fulfil their retirement savings plans. At the very least the period should be extended out to seven years, which would be broadly in line with saving to reach their lump sum RBL (albeit before contributions tax).

In addition, while the $50,000 annual limit for deductible contributions will provide greater flexibility for most contributors, it does not recognise changing work patterns or the cyclical nature of work, particularly for the self-employed. The self-employed, such as primary producers, often experience large variations in the amount of income they receive from their businesses and will only contribute to superannuation when financially able. There may well be years when they do not contribute at all, then there will be years where they wish to contribute more than the $50,000 limit to make up for the lean years. As such we suggest provision also be made to allow the annual $50,000 limit to be averaged over a period of five years, in a similar manner to what is proposed for undeducted contributions.

Averaging the deductible contribution limit over a number of years would also address the potential problem of individuals exceeding their limit in any one year due to circumstances beyond their control. Examples would be an employer paying 13 months worth of monthly contributions in a twelve month period, a percentage of a larger than expected bonus being salary sacrificed to superannuation or changing jobs.

Undeducted contributions

We also support a limit on undeducted contributions, as it is a reasonable trade off for the abolitions of the RBLs, and we support it being averaged over multiple years. However, we suggest it be averaged over five years, which again would be broadly equivalent to the current lump sum RBL.

A common strategy for many retirees has been to sell off investment property and contribute the proceeds to superannuation as an undeducted contribution. Averaging the limit over five years would better recognise the higher value of real estate, particularly in the capital cities. The longer averaging would give imminent retirees more flexibility to boost their retirement savings without being unduly excessive. We also suggest the limit is averaged forward to provide more flexibility.

While we support the limit on undeducted contributions, we believe the immediate application of it from 9 May 2006 is unfairly restrictive and has the potential to severely disrupt the retirement plans of many people close to retirement. The most immediate impact is on individuals who may be in the middle of implementing strategies around undeducted contributions, for example a recontribution strategy, and may have realised assets and are now unable to finalise the strategy. These are people who have paid for financial advice and had the expense of implementing the strategy on the good faith that the rules they were operating under at the time would not change.

As the proposal to cap undeducted contributions from 9 May 2006 is just that, a proposal, the uncertainty around it is preventing the finalisation of financial advice and the realisation of retirement plans. As such, we suggest the commencement date be deferred to at least until 31 December 2006 (if not longer)[1], to allow people who have been making larger undeducted contributions for genuine reasons to finish doing so.

If the cap on undeducted contributions was to apply from 9 May 2006, we seek clarification of which period it would apply to. The period 9 May 2006 to 30 June 2006 or the whole of the 2005-06 financial year, in which case there are likely to be many cases of contributions made before Budget night exceeding the limit?

Tracking undeducted contributions made before 30 June 2006 will be further complicated by the large number of funds closing and transferring benefits before the commencement of the new APRA licensing regime. Once a benefit is transferred or rolled over the receiving fund will not be able to identify if contributions were made before or after 9 May 2006.

Introducing the limit from a later date would reduce this complexity and potential for confusion.

It is proposed earnings on refunded excessive undeducted contributions will be effectively taxed at the top marginal tax rate. Given equivalent earnings outside of superannuation would be taxed at an individual's marginal tax rate, this seems excessive. We suggest the refunded earnings should be taxed at the individual's marginal tax rate less 15% for the tax already paid on the earnings in the fund. This could be achieved quite easily by including the earnings in their assessable income.

Contributions over age 70

It is proposed that contributions made by or on behalf of individuals aged 70 to 75 will be fully tax deductible from 1 July 2007. Currently, contributions can only be made for this age group if they are mandated or made by the individual and there is no mention of this restriction being relaxed. In line with the extension of deductibility we suggest the restrictions on employer contributions be removed up to age 75.

[1] Note, CPA Australia had previously requested the commencement date be deferred to 30 June 2006. However, as it is now June and the uncertainty remains, we believe people will need more notice in order to properly implement their plans.

The immediate cap on undeducted contributions also disadvantages individuals aged 70 to 75 as they are now limited in the personal contributions they can make but cannot have deductible contributions made on their behalf until after 30 June 2007. To alleviate this, we suggest the ability to claim a deduction for contributions made by or on behalf of someone aged 70 and over be brought forward to 1 July 2006.

Administration of contribution limits

Given the undeducted contribution limit will apply from sometime before 1 July 2007, when will funds be able to refund excessive contributions? For this, and any other measures implemented before 1 July 2007, legislation is need as soon as possible to provide funds with ample time to implement changes.

Further, implementing the new contribution limits, extra tax on excessive deductible contributions and refunds of excessive undeducted contributions, will be administratively complex for superannuation funds and the ATO. It is important that mechanisms are put in place to minimise this complexity. We suggest roundtable consultation be held with the industry, Treasury and the ATO to ensure adequate, fair and efficient mechanisms are developed.

As mentioned previously, there may be occasions where an individual exceeds a contribution limit through no fault of their own. As such we suggest the Commissioner of Taxation be given appropriate discretion to be able to determine that particular contributions are within the limits.

Exemptions to contribution limits

It is proposed there will be certain exemptions from the undeducted contribution limit, such as the CGT exempt component. We seek clarification of other possible exemptions.

Will the Government co-contribution, which is currently treated as an undeducted contribution within a fund, also be exempted from the cap?

Following on from this, individuals receiving a benefit from an overseas superannuation fund can elect to have a portion of the benefit treated as a taxable contribution to their fund and taxed accordingly. Will these amounts, which are essentially earnings on existing benefits, be excluded from the deductible contribution limit?

Also, some overseas regulations (eg the United Kingdom) only permit benefits to be transferred to pension funds if they satisfy particular rules. Has consideration been given to how the simplification of the pension rules may affect this?

Employer ETPs

While we support a cap on the concessional tax treatment of employer ETPs, we believe it should be set at a level that will provide fair concessions, when they are most needed, for example for individuals receiving genuine redundancy payments while still limiting the concessional treatment afforded large “golden handshakes”. While the proposed cap is simple it doesn’t recognise the fact that the employer ETP may actually be the result of a redundancy benefit that may ‘accrue’ over many years of service.

We acknowledge the tax-free amount for bona-fide redundancy payments recognise this but we believe this could be better recognised in the concessional tax treatment of employer ETPs. As such, we suggest the cap be based on a flat dollar amount for each year of service, for example $50,000 per year. That way an employee retrenched after 10 or 20 years of service would receive a greater and fairer concession than, say, an overseas executive who receives a large multi-million dollar golden handshake after only two years of service.

If the flat dollar cap is to be maintained, we suggest a limit of $250,000 would be more appropriate, or at least $150,000, which would then be in line with the personal income tax threshold at which the top marginal tax rate commences.

Untaxed schemes

As untaxed schemes do not pay tax on contributions and earnings as they are received, we support the principle that benefits from these schemes should be taxed at a higher rate than benefits from taxed funds to compensate. Currently the differential is generally 15% (10% for under 55s), which we believe is fair and reasonable to compensate for the taxes foregone on contributions and earnings.

However, we believe the proposal to tax at the top marginal tax rate that part of the post-June 1983 untaxed element above the threshold of $700,000 is no longer fair or equitable. There remains, in effect, a de facto RBL for members of unfunded schemes. Something their counterparts in taxed funds no longer have to contend with. The result is that they will now be paying considerably more tax than their taxed fund counterparts on benefits above $700,000, putting them at a distinct disadvantage.

We suggest a much fairer and simpler approach, which would also maintain parity between members of untaxed schemes and taxed funds, would be to apply the 15% or 30% tax rates as proposed to the whole untaxed component without any upper limit at which a higher rate of tax would apply.

Age	**Tax on post-June 1983 Untaxed element**
Under 55	30%
55 to 59	15% - up to low-rate threshold 30% - over threshold
60 and over	15%

Similarly the treatment of pensions from an untaxed source seems inconsistent compared to those from a taxed source. We believe it would be more equitable if the rate of tax reflected the contributions and earnings tax forgone without being excessive.

Portability

We support the tightening up of the benefit transfer period from 90 to 30 days. However, we question the requirement that transfers must be made within 30 days. Despite the best intentions, and a standardised request form, there will still be circumstances where insufficient or incorrect information is provided. In these cases funds must have the flexibility to reject transfer requests.

Indexation

A number of thresholds have been proposed in the Plan, specifically the limits for deductible and undeductible contributions and employer ETPs, the lump sum threshold for benefits from untaxed schemes and the ETP tax-free/low tax threshold. However, there is no mention of these thresholds being indexed.

We seek confirmation that these thresholds will be indexed. To maintain them in real terms we suggest they are indexed in keeping with the traditional indexing of superannuation thresholds.

In addition to the new thresholds, will the CGT exempt component be increased and/or indexed? Having been introduced in 1999, indexation would maintain its value in real terms.

Public awareness important

There has already been much speculation that the removal of most of the tax incentives to take superannuation as an income stream will lead to more retirees taking a lump sum, exhausting their benefit and then accessing the age pension. We do not share this view as we believe the majority of retirees will recognise the value of their superannuation savings and the difficulty of living on the age pension alone.

Nonetheless, we believe it is imperative a public awareness campaign accompanies the changes next year to not only properly explain the changes and their impact but to also highlight the importance of maintaining an adequate income in retirement and the dangers of exhausting your benefit prematurely. We would see the Financial Literacy Foundation having an important role in coordinating this in conjunction with the financial services industry.

Consequential amendments required

Section 116 of the Bankruptcy Act 1966 currently protects superannuation benefits from claims by creditors up to the pension RBL. With the abolition of the RBLs a new limit will need to be introduced to maintain this protection.

The Superannuation Guarantee (Administration) Act 1992 permits employees to opt out of having SG contributions paid on their behalf if their accumulated benefits exceed their pension RBL. This election is irrevocable. With the abolition of the RBLs this provision will no longer be relevant and we suggest existing elections be permitted to be revoked.

Other SIS amendments requested

As the implementation of the Plan will require considerable legislative change, we would like to take this opportunity to request an additional amendment to the SIS Regulations.

Schedule 1AAA of the SIS Regulations lists the professional organisations whose members can be auditors of superannuation funds provided they meet the conditions under the definition of “approved auditor” in sub-regulation 1.04(2).

Item 1 of Schedule 1AAA refers to the Australian Society of Certified Practicing Accountants. The Society’s name was actually changed to CPA Australia on 28 April 2000. As such, we ask that the SIS regulations be amended to reflect this.