Financial Planning Association
of Australia Limited
ABN 62 054 174 453

Level 4, 75 Castlereagh St
Sydney NSW 2001

PO Box 4285
Sydney NSW 2001

Tel: 02 9220 4500
Fax: 02 9220 4580

Member Freecall: 1800 337 301
Consumer Freecall: 1800 626 393
Fax: 03 9627 5280

fpa@fpa.asn.au
www.fpa.asn.au

9 August 2006

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

Dear Mr Lonsdale

FPA COMMENTS ON SIMPLER SUPERANNUATION PROPOSALS

The Financial Planning Association of Australia Limited[1] (FPA), the peak professional association for financial planners in Australia, appreciates the opportunity to comment on the Government's 'Plan to Simplify and Streamline Superannuation'. The proposals have the potential to enhance significantly the retirement savings of many Australians and encourage older Australians to continue in paid employment if they so wish. Treasury's willingness to consult and take account of industry concerns during finalisation of the proposals is welcomed by the FPA, and can only facilitate the development of a workable and effective superannuation framework.

The FPA has been actively involved in the public debate on superannuation issues and has acknowledged the many positive initiatives of the Government in superannuation, including examples such as the introduction of Choice of Fund; portability; Government co-contributions; and contribution splitting. In light of its submissions in 2005 to the Assistant Treasurer and the Business Regulation Review Taskforce, the FPA is particularly pleased that the Government has sought to simplify superannuation, including the removal of Reasonable Benefit Limits (RBLs).

The FPA looks forward to working with Treasury and other stakeholders to provide an effective superannuation system that removes undue complexity, and operates in a fair and equitable manner. Further to its submission to Treasury dated 6 June 2006, dealing with transitional issues arising from the Budget proposals, the FPA has identified additional issues which it believes should be addressed when implementing changes to the superannuation regime.

I note for your attention that, while the FPA supports the removal of RBLs and the elimination of end benefits tax on superannuation withdrawals, and as a result is comfortable that there are sound policy reasons for the introduction of a cap on undeducted contributions, the level of the proposed cap remains by far the major concern of FPA members. A cap of $150,000 per annum, even when allowed to be averaged over three years, will have a major unwarranted adverse

[1] With approximately 12,000 members organised through a network of 31 Chapters across Australia and an office located in each capital city, the FPA represents qualified, professional financial planners who manage the financial affairs of over five million Australians with a collective investment value of more than $560 billion.

impact on many of our members' clients. As detailed in the submission, those who will often be hit the hardest are clients who have been planning carefully to finance their retirement.

For Treasury's convenience, the enclosed submission includes all issues which the FPA recommends the Government address, including those transitional measures covered in our 9 June submission. The FPA has aimed to provide Treasury not only with an explanation of why each issue identified should be addressed, but also with practical recommendations as to how the system may be improved.

If you would like to discuss any of the issues raised in this letter, please contact our Manager of Policy and Government Relations, John Anning (tel: 02 9220 4513; email: john.anning@fpa.asn.au).

Yours sincerely,

Jo-Anne Bloch
Chief Executive Officer

SUBMISSION TO TREASURY

A PLAN TO SIMPLIFY AND STREAMLINE SUPERANNUATION

9 AUGUST 2006

Prepared by:
The Financial Planning Association of Australia Limited

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UNDEDUCTED CONTRIBUTIONS

The FPA is concerned with both the effect that the immediacy of the introduction of the cap on undeducted contributions will have on many people, and the unwarranted impact on certain groups that the cap may have on an on-going basis (see below).

Clearly the people who will be worst affected by the introduction of the cap from 10 May 2006 (and its effectively retrospective nature), are those who have either recently retired, or who have commenced a transition to retirement. It is especially harsh that the people who will be most disadvantaged by the proposed changes are the ones who have been carefully planning for retirement under the Government's current rules in order to maximise their total retirement income and decrease their reliance on Government assistance.

In many instances, documented plans have been developed and were in the process of being implemented. From its members the FPA is aware of a significant number of examples where people had already executed a taxable transaction in preparation for their retirement and are now unable to complete the final stage of their retirement plan due to the immediacy of the proposed changes.

Furthermore, if the cap is maintained at the $150,000 per annum level as is currently proposed (with $450,000 allowed to be averaged over 3 years), people who had intended to undertake retirement strategies in future years that rely on large undeducted contributions will generally be unable to contribute the full desired amount to their superannuation.

A retirement strategy involving a large undeducted contribution is commonly implemented in a wide range of situations. It should be noted that in the majority of these situations a large contribution to superannuation is required to be made near retirement by necessity, not due to any intention on the part of the contributor to minimise tax obligations. As well, the contribution desired is generally well in excess of $450,000, let alone the $150,000 annual limit.

The following are examples of persons on whom the proposed cap of $150,000 on undeducted contributions may have an unwarranted adverse impact:

- **Small business owners** - Require a high degree of liquidity to run their businesses effectively, and are thus unable to generate significant superannuation balances prior to their retirement. Small business owners often regard their business as their superannuation savings and contribute the sale proceeds into superannuation;
- **Rural families** - Rural families are unable to contribute significant amounts to their superannuation prior to selling their farms, after which it is unrealistic for them to meet any work test;
- **Recipients of inheritances** - Inheritances are commonly relied upon by persons with inadequate superannuation balances to fund their retirement, and are an especially important source of funds for many women who do not have large superannuation balances (due to the years they have spent raising children);
- **People who sell property to fund their retirement -** This strategy is commonly implemented not only by long-term property investors but also by persons who downsize their homes to fund their own retirements, an increasingly common strategy;
- **Recipients of lump sum disability and other compensation payments** - Such payments are designed to create an equitable position for people who have suffered misfortune, yet these people are being further penalised after being compensated by not being able to contribute adequately to their superannuation;
- **Single persons** - Single people enjoy less flexibility than married couples as they are not able to make any contributions to their spouse's superannuation accounts and are therefore more significantly disadvantaged by the cap on undeducted contributions;

- **Persons who suddenly become ill** - Persons who intend to keep working for several years but are then forced to retire prematurely due to poor health may now be unable to contribute an adequate amount to their superannuation, or even to take advantage of the averaging provisions for an already contributed amount; and
- **Recontribution Strategies** - After consulting with financial advisers, many people (based on the ATO's press release of August 2004) have withdrawn a benefit from their superannuation in order to later re-contribute it as an undeducted contribution, and commence a tax effective income stream.

While the FPA acknowledges that it is important to avoid abuse of the new tax concessions on superannuation by having some limits on contributions, the FPA recommends the measures set out in the following paragraphs to assist the transition to, and the effective implementation of, the proposed Budget changes regarding undeducted contributions.

i) a) Removal of the Work Test for Persons Aged Between 65 and 74 Years of Age for Undeducted Contributions

The FPA believes the work test should be removed effective from 10 May 2006 for people between the ages of 65 and 74 years of age in respect of undeducted contributions to superannuation. This would provide individuals who had arrangements in place prior to Budget night with more time to make a series of contributions falling within the proposed annual caps for undeducted contributions. Furthermore this would give certain groups of people who (as per the examples above) often have little money in superannuation and by necessity are required to make large contributions to their superannuation at the time of retirement, the capacity to contribute additional funds. This alteration would provide an opportunity for more Australians to achieve their retirement goals whilst minimising their reliance on Government social security.

Those who are over 65 and have not yet managed to save enough for their retirement, as well as those who are in the process of organising their retirement income streams into superannuation, have been particularly disadvantaged by the introduction of the low caps on undeducted contributions to superannuation effective from Budget night. Removing the work test for undeducted contributions would greatly assist in remedying the situation for each of these categories of people.

The FPA acknowledges Treasury's view that the work test is not especially onerous and that most would be in a position to keep meeting the work test after age 64 if their financial situation necessitates they do so. However, it is not always easy or possible to obtain gainful employment in latter years. In the majority of situations where a large undeducted contribution is required as part of a retirement strategy, the person involved will not be in a position to meet even a 'non-onerous' work test. This will generally hold true for people selling small businesses, rural families selling their farms, people receiving disability payouts, people receiving inheritances (especially women), and working people over 65 who suddenly become ill. If significant additional workforce productivity is unlikely to be encouraged through the existence of a work test for undeducted contributions, and it increasingly discriminates against certain classes of people, then its value must be called into question.

Recommendation
Remove the work test requirement for persons aged between 65 and 74 years of age in respect of undeducted contributions.

i) b) A person should only be required to meet the work test in the year they make the relevant contribution

"A Plan to Simplify and Streamline Superannuation - Fact Sheet" released 26 June 2006, states that a person needs to satisfy the work test in each of the financial years to which the averaging rule applies in order to attain the applicable tax concessions. If a contribution is made under

averaging but the person fails to meet the work test in a subsequent year, this will necessitate a clawback which creates unnecessary complexity. The FPA submits that this can be avoided by applying the work test only in the year they make the applicable contribution. It should be irrelevant whether a person meets the work test criteria during the second or third year after the averaging rule is invoked. This is in line with current legislation which tests eligibility in the year the contribution is made.

The current position that a person can only 'bring forward' entitlements from years in which they meet the work test adds unnecessary complexity to a process that is supposed to be simplified. It also raises a range of issues that will confuse people implementing the averaging rule, and are likely to lead to a substantially increased administrative burden. For example, if the averaging rules continue to be interpreted as they currently are by Treasury, it is not clear what the outcome would be in the following situations:

- A client makes the maximum allowable undeducted contribution under the averaging rules and then passes away. Are the contributions returned for the years they did not meet the work test, or do they form part of a death benefit? How are contributions recovered if distributions to beneficiaries are already made?
- A client makes the maximum allowable undeducted contribution with the intention to continue working, however due to unforeseen circumstances the client becomes disabled and is no longer able to work. How should this situation be treated?
- A client commences a non-commutable income stream after making the maximum undeducted contribution and then does not meet the work test in subsequent financial years. How would the money be able to be refunded by the provider?
- A client makes the maximum allowable undeducted contribution, and subsequently takes the benefit as a lump sum. If the person does not meet the work test in the following financial years, how should this be treated?

A complex set of rules would be required to cover these as well as other situations. In order to maintain the policy aim of simplifying the superannuation system, the most appropriate option would be to require a client to meet the contribution rules only in the financial year in which the relevant contribution is made.

Recommendation
When making an undeducted contribution under the averaging rule, a person should only be required to meet the work test in the year in which the contribution is made.

ii) Transitional Arrangements
The Treasurer's Press Release No. 058 dated 13 June 2006, "A Plan to Simplify and Streamline Superannuation – Transitional Issues that Apply Immediately", provided limited guidance concerning the implementation of an averaging rule over three years for undeducted contributions. However, the FPA would argue that the situation regarding transitional arrangements for persons over 50 should be adjusted to take regard of the difficulties facing those who have commenced retirement strategies involving large one-off payments and to ensure consistency with the transitional rules for deductible contributions.

The Budget Paper, "A Plan to Simplify and Streamline Superannuation – Detailed Outline" of May 2006, states that the cap of $150,000 was calculated based on it being "three times the proposed concessional contributions limit". Further, the Budget proposals provide that those aged over 50 have a transitional period where a deductible contribution of $100,000 would be subject to the concessional tax rate of 15%. To quote from the above paper, "these transitional arrangements would allow people who are planning to retire in the immediate future to continue to make larger contributions at concessional rates".

To maintain this logic and the simplicity of the superannuation system, the transitional rules that apply to deductible contributions should also flow through to undeducted contributions for those aged over 50. As such the "three times the proposed concessional contributions limit" criteria used to calculate the undeducted contributions limit, should also be applied to the transitional $100,000 concession applying to deductible contributions for those aged over 50. Therefore, during the transitional period, the undeducted contribution limit per year for those over 50 would be $300,000.

The averaging rules in the Treasurer's Press Release should also continue to apply as normal. This would allow those aged over 50 to contribute $900,000 averaged over three years during the transitional period ending 30 June 2012, and would go a long way towards remedying the inequitable situations created by the retrospectivity of the proposed rule changes.

Recommendation
A transitional arrangement allowing undeducted contributions of "three times the proposed (transitional) concessional contributions limit" should be implemented. In practice this would permit undeducted contributions of $300,000 to be made to superannuation each year up until 30 June 2012. Implementing the averaging rule would then allow a $900,000 undeducted contribution to be averaged over three years.

iii) Allow for the $150,000 cap to be averaged over five years
The FPA notes the Treasurer's media release of 13 June 2006 stated that an averaging of the undeducted contribution limit over three years will be introduced. An averaging of the undeducted contribution limit is welcome but the FPA believes an averaging over five years would be more appropriate given the sums of money often involved in respect of a number of common retirement strategies. The FPA also notes that for a five year averaging rule to work most effectively, Treasury would also need to implement FPA's recommendation above to require that the work test only need be met in the year in which a contribution is made.

This would allow people who are nearing retirement and have been placed in the precarious position of already having commenced a retirement strategy involving a large one-off payment, to place up to $750,000 into superannuation. From the comments received from concerned members, the FPA believes that this would more adequately reflect the amounts of money commonly involved in the retirement strategies described above rather than $450,000 averaged over three years.

Allowing for an averaging over five years would not only help minimise the adverse impact the proposed cap would have on people who have carefully planned ahead for their retirement, but would also still allow realistic scope for retirement strategies involving significant undeducted contributions to be carried out effectively in the future. This would be especially important for small business owners and rural families for whom, despite a life time of hard work, it is often impractical to build up their superannuation until very close to their retirement. A five year averaging period would be facilitated by the current requirement to retain taxation records for five years.

Example:

- Client couple A and B owned a successful business and sold it at the end of 2005, retiring with only a small amount in superannuation. They have been long-term clients of a financial planner and have always said "our business is our superannuation". The business was sold for a profit of more than the cap on the "small business CGT rollover exemption" and thus will shortly pay a very large CGT bill.

  A and B have contributed, so far, about half of their wealth to superannuation, but there remains a commercial property from the business and some other assets to be sold and

transferred into their superannuation fund. If the undeducted contribution cap is implemented it would take them about 10 years to contribute all of their assets. A and B have spent years "doing the books" and want to get away from this, but it will take them a long time to achieve their goal if the cap is introduced. If applied, the work test would actually limit some of the transfer from occurring at all.

Recommendation
The $150,000 cap for undeducted contributions should be allowed to be averaged over five years. This would better reflect the sums of money generally involved in retirement strategies involving large one off contributions.

iv) Amend definition of CGT exempt component for small businesses
Many small business owners are unable to contribute sufficient amounts to superannuation on an ongoing basis. Instead they build up their businesses with the intention of using sale proceeds at retirement to make a one-off contribution to superannuation to fund their retirement. However, this is now significantly restricted with the introduction of a low annual cap on undeducted contributions.

In some situations small businesses can mitigate this by claiming the CGT exempt component to turn up to $500,000 per eligible owner into an eligible termination payment, which can then be rolled over to superannuation.

However, clients who owned their business pre-20 September 1985 (when CGT commenced), or for at least 15 years (making them eligible for the 15 year CGT exemption), are not able to use the CGT retirement exemption. In cases where it can be fully utilised, it will only assist in getting some of the capital gain portion of the sale proceeds into superannuation and will not apply to the capital invested into the business.

Recommendation
The FPA recommends the definition of the CGT exempt component be extended. It should continue to allow a conversion of up to $500,000 of taxable capital gains into an eligible termination payment. But it should also allow the conversion of the total sale proceeds into an eligible termination payment (as a tax free component) which can then be rolled into superannuation and will not be counted as part of the limit on undeducted contributions.

Issues for Clarification
The FPA also seeks clarification from Treasury on the following issues relating to the cap on undeducted contributions:

i) We would appreciate clarification that Government co-contributions, and rollovers or transfers from other funds within the superannuation system would be excluded from the cap. (We note from page 31 of the Simpler Superannuation paper that the $500,000 CGT exempt component of the sale of a small business will be outside the cap).

ii) We seek clarification that money transferred into superannuation from recognised overseas retirement schemes will not be included in the cap. A condition of transferring this money to Australia is that it will be preserved in superannuation, so it would be unfair to penalise persons who have genuinely lived overseas by including this amount in the cap. In order to ensure the integrity of the system, the Government may wish to implement conditions based on reasonable amounts and allowable time periods to ensure the transfers are limited to amounts accumulated legitimately during periods of employment overseas.

iii) We assume that contributions made on behalf of a member by a spouse would be counted towards the cap of the member and not the contributing spouse.

iv) We note the Government's clarification that contributions received prior to 10 May 2006 would not be counted towards the cap despite the fact that they relate to the 2005/6 financial year.

DEDUCTIBLE CONTRIBUTIONS

While the introduction of a standard $50,000 limit applying to people of all ages does provide a degree of simplification, it assumes that people are able to contribute a consistent amount to superannuation throughout their entire working life. This is generally not the reality.

The FPA believes the $50,000 threshold, which under the Budget proposals will eventually apply to recipients of all ages, will prove insufficient for people nearing retirement age. This group of people not only have the desire to contribute more to superannuation, but also usually have the additional capacity. This is supported in the recent House of Representatives Economics Committee report on improving savings of the under 40s which recognised that people generally do not have the ability to channel additional funds into superannuation until close to retirement. As the report points out, it is unlikely that many people under age 40, experiencing the high start-up costs of purchasing an owner-occupied dwelling and the expenses of child rearing and education, would possess the capacity to contribute anywhere close to the $50,000 limit. Conversely, it is more likely that people over the age of 50 years will have the capacity and increased focus to divert extra funds towards their retirement benefit.

The FPA agrees that it is desirable that people plan ahead and begin saving for their future at a young age. However, in practice, increasing the concessional deductible contribution limits for people aged under 40 will only benefit a small percentage of the population. Furthermore, those people who are most advantaged by the proposed changes will generally be high income earners who would have had little difficulty funding their retirement anyway, so the future drain on the social security system will not be significantly reduced. While encouraging persons under 40 to save more is a worthwhile policy goal, doing so at the expense of allowing people to 'catch up' in their later years to fund their own retirement may result in an overall poor result. The FPA believes it is likely that if persons over 50 are limited to only a $50,000 concessional contributions limit, considerably fewer people will be able to fund their own retirements.

The proposal paper also suggests that tax deductions will be allowed for eligible contributions up to age 74 (inclusive). However, currently superannuation funds are not able to accept non-mandated employer contributions from age 70. Therefore, this requires an amendment to the contribution rules. The FPA recommends that the contribution rule be amended to allow non-mandated employer contributions up to age 74.

Recommendation
The FPA recommends the transitional allowance for over 50s to contribute $100,000 per annum be extended indefinitely so in fact two thresholds will operate; $50,000 for under 50s, and $100,000 for over 50s. This will ensure superannuation savings over time are more closely matched to the savings capacity of the individuals for whom the contributions are made. This proposal is based on a realistic assessment of people's ability to save for their retirement and would retain the superannuation system's simplicity.

The contribution rule should be amended to allow non-mandated employer contributions up to age 74 (inclusive).

INDEXATION

The proposal paper is silent on whether the thresholds for deductible contribution limits and undeducted contribution limits will be indexed on a yearly basis in line with inflation. The FPA believes that it is important these thresholds are indexed annually in a way that preserves the real value of the simplified limits. This would encourage savings to be placed in the superannuation system and allow people to prepare effectively for their retirement. The FPA is mindful that indexation should not introduce an unnecessary level of complexity.

Currently, the principle of maintaining the real value of various "pre simplification" limits applies to several measures, for example the Superannuation Guarantee maximum quarterly contribution base, Reasonable Benefit Limits, Maximum Deductible Contributions, and the low tax rate threshold for Eligible Termination Payments. The FPA believes that the principle of maintaining real value is a solid one, and is essential to ensure the good work of the Government in encouraging saving in the community within a simplified superannuation system will not be undermined over time. Indexation will become particularly important during periods of sustained price inflation.

Recommendation
Introduce a system of indexation for the limits on concessional deductible contributions and undeducted contributions, so that the real value of the limits are maintained and people continue to be encouraged to make full use of the superannuation system.

COMMUTATION OF PENSIONS

It is unclear from the Budget proposal paper how existing complying income streams will be treated when the new pension standards come into effect from 1 July 2007. There are currently two distinct purposes for commencing a complying income stream. These are to access the pension RBL, and to access either a 50% or 100% assets test exemption for social security purposes. The cost of accessing these concessions is the loss of access to capital.

With the abolition of RBLs, it is unfair for those who entered into a complying income stream to target the pension RBL, to continue to have their funds locked up in these arrangements unnecessarily. If they were to commence their retirement post 1 July 2007 without RBL issues to consider, they would of course have ongoing access to their retirement funds.

Similarly, many people made a choice to lock money into a complying income stream when the age pension assets test reduction rate applied at $3.00 per fortnight. Even though the assets test reduction continues past 20 September 2007, the new reduction rate of $1.50 will halve the value of this strategy. For many people, had they foreseen this outcome, they would not have decided to lock their money away.

It is the FPA's recommendation that people who entered into such arrangements should have, at the discretion of the fund manager, the option to commute to pensions that are more suitable for them under the proposed Budget changes. However, it is recognised that people who have commenced a complying income stream to gain an assets test exemption should be able to retain their investment in these products should they so choose.

The FPA is also of the view that defined benefit pensions in SMSFs should be able to be commuted in order to remove the significant complexity involved in managing these types of income streams (a concern already expressed by the Government in preventing their use since 31 December 2005).

We acknowledge there is complexity in this area due to the various types of complying income streams (for example market linked, defined benefit pensions paid from both SMSFs and externally purchased, and lifetime contractual pensions or annuity products). We therefore recommend a number of separate solutions be explored based on the type of complying income stream.

Recommendation
Allow term allocated pensions (market linked income streams) to be commuted at the discretion of the fund manager.

Consult with life insurance companies to determine if an option will be granted to allow lifetime and term certain income streams to be commuted. The consultation needs to take into account the financial impact on capital requirements. In many cases, due to the commutation values, clients may choose not to commute even if the option is made available.

Allow defined benefit pensions paid from SMSFs to be commuted to the new type of pension.

Any option to commute (as cash or rollover to another income stream) should only be allowed for a fixed window of 12 months from announcement of the decision. This would allow advisers and product providers time to review systems and client accounts, while minimising abuse of the availability of social security.

If commutations are made in this period, there should be no claw back permitted of social security benefits or any taxation reassessments.

NEW PENSIONS

The FPA supports the removal of legislative restrictions on pensions, and the removal of the legislative distinction between different types of income streams able to be offered to retirees. The FPA also supports the proposed minimum standards to the extent that they require minimum annual payments and do not restrict access to capital.

The FPA would though like further clarity on the standard that requires “no provision to be made for an amount to be left over when the pension ceases”. We assume this refers to current fixed term pensions and annuities that allow a residual amount of capital (RCV) at the conclusion of the term. It would appear that, for example, 100% RCV annuities will not be available after 1 July 2007. However, these types of income streams have many uses as part of a retirement strategy. They can be particularly beneficial in providing protection from the interest rate cycle where a retiree wishes to select a low risk investment with capital certainty and guaranteed income. The FPA therefore recommends that pensions and annuities with residual capital values should continue to be available after 1 July 2007.

The proposals paper allows for the continuation of Guaranteed Lifetime Pensions provided on an arm’s length basis. The FPA would like clarity as to whether this means that new guaranteed lifetime pensions will be able to be purchased, or simply that existing pensions will be able to continue in their current form. The FPA recommends that Guaranteed Lifetime Pensions or Annuities offered by superannuation funds or life companies should continue to be permitted.

Recommendation
The FPA recommends that pensions and annuities with residual capital values should continue to be available after 1 July 2007.

The FPA recommends Guaranteed Lifetime Pensions or Annuities offered by superannuation funds or life companies should continue to be available.

DEATH BENEFITS

The treatment of superannuation benefits on death are at present quite complex. For a client and their adviser to be able to put in place an effective estate plan they need to consider a wide range of issues. Some of the applicable issues are listed below with recommendations as to how the relevant rules may be made simpler and more effective.

i) Who can receive the superannuation benefit on death?
This can include a spouse (including a de facto but not an ex-spouse), a child of any age, someone who is financially dependant, or someone who is in an interdependency relationship. The definition of a dependant in this sense is different to the definition of a dependant for tax purposes which does not include adult children but does include an ex-spouse, and is different again to an eligible beneficiary for anti-detriment purposes (s.279D of ITAA) which excludes a financial dependant.

In line with the theme of simpler super, the FPA recommends aligning these definitions by replacing the tax and anti-detriment definitions with the Superannuation Industry (Supervision) Act (SIS) definition of a dependant. This means that any time a trustee pays a lump sum death benefit directly to a beneficiary it would all be tax free and an anti-detriment benefit would be available. The same would also apply if the trustee paid it to the estate and it was then paid to a SIS dependant. If the trustee instead pays a lump sum to the estate and it is paid to a beneficiary who is not a dependant for SIS purposes, then the benefit should be taxable as per the current rules and no anti-detriment benefit should be payable.

Allowing tax free death benefits to all dependants has the added benefit of limiting the administrative complexity for funds paying pensions. Under the current proposals, funds are required to track the components of a member's benefit whilst paying a pension in order to tax appropriately the taxable components of a death benefit paid to a non-dependant.

If these definitions are not aligned, arbitrage opportunities will exist for members who have non-tax dependant beneficiaries. For example, members over age 60 can cash out lump sums or draw income payments tax free which they can pay to an adult child tax free while they are alive, rather than having it pass as a taxable benefit after their death. An alternative is to cash out benefits tax free after age 60, and re-contribute the money back to super for them and/or their spouse as an undeducted contribution (subject to contribution limits). This benefit, containing only an undeducted component, will subsequently be paid tax free to non-tax dependants.

If death benefits continue to be taxable for a person who is a SIS dependant but not a tax dependant, then we may be faced with the anomaly of superannuation being tax free in the person's lifetime but taxable upon their death. This could encourage people to make withdrawals to commence the transfer of their estate while they are still alive, rather than using the funds to support their own retirement needs.

Recommendation
The SIS definition of dependant should also apply for tax and anti-detriment purposes.

ii) How can superannuation death benefits be paid?

Under the current rules, trustees can pay a superannuation death benefit directly to SIS dependants in the form of a lump sum, a pension or a combination of both. Benefits paid to the estate can only be paid as lump sums.

The Budget papers state that a non-tax dependant such as an adult child will not be able to continue a pension on death and therefore will be forced to receive a taxable lump sum. The papers do not explain the possible options on death in the accumulation phase.

The FPA recommends that all SIS dependants should retain the option of receiving death benefits in the form of a lump sum, pension or a combination of both (subject to fund rules). The FPA does not support restricting the choices for beneficiaries in either the accumulation or pension phase. Also, trustees should not be prevented from paying death benefits to multiple beneficiaries if they are dependants for SIS purposes. This approach will make it easier to manage estate planning from an individual's perspective.

The FPA would like clarity on this issue as soon as possible as many people have already put together estate plans based on current rules, and are faced with ongoing uncertainty about the rules at the time of their death.

Recommendation
The FPA recommends that all SIS dependants should retain the option of receiving death benefits in the form of a lump sum, pension, or a combination of both (subject to fund rules). Also, trustees should not be prevented from paying death benefits to multiple beneficiaries if they are dependants for SIS purposes.

iii) How are superannuation death benefits taxed?

It is proposed that from 1 July 2007, RBLs will be abolished and therefore dependants for tax purposes will be able to receive an unlimited amount of superannuation death benefits tax free. Clarity is required around the taxation treatment of superannuation death benefits to a non-tax dependant. An explanation is required of the differences, if any, between superannuation in the accumulation phase compared to when superannuation benefits are being paid, in particular to the inclusion of insurance benefits paid through superannuation.

If a lump sum ETP is paid to a non-tax dependant, it is proposed that the exempt component is not taxed and the taxable component is taxed at 16.5%. It is unclear from the announcements whether a death benefit payable to a non-tax dependant that contains an insurance component will be taxed at a higher rate of 31.5% on this (untaxed) taxable component, as is the case currently, or at the 16.5% rate applying to all other taxable components.

Recommendation
For simplicity and equity, the FPA recommends that the tax rate on the taxable component be limited to 16.5%, even if this includes an insurance component paid through superannuation. At a minimum, the FPA asks for clarification on the issue of taxation treatment for superannuation death benefits paid to a non-tax dependant.

iv) Increased Administrative Complexity

If death benefits remain taxable depending on the status of the beneficiary, it adds a level of administrative complexity to superannuation and will increase the administration cost.

Lump sum payments paid to a person over 60 are tax free. Income payments are also tax free if either the primary pensioner was aged over 60, or the reversionary pensioner is aged over 60. In both cases there is no need to track the various ETP components, but providers still need to track the tax-exempt components (including the frozen pre '83 and concessional components) and the taxable components over time, in case the eventual death benefits are paid to non-tax dependants.

Recommendation
As recommended above, if the tax definition of dependant were aligned with the SIS definition, then this would significantly reduce the level of complexity. Providers of superannuation funds as well as financial advisers then would not need to concern themselves with components beyond age 60.

EMPLOYER ELIGIBLE TERMINATION PAYMENTS

Under the proposed changes to employer ETPs, two taxation treatments would apply to employer ETPs:

I. Exempt amounts (post June 1994 invalidity and pre July 1983).
II. Taxable amounts (post June 1983 - untaxed element).

From the taxable component, the first $140,000 will be taxed at 15% for people aged 55 and over, and at 30% for people aged less than 55. Amounts in excess of $140,000 will be taxed at the top marginal tax rate.

Presently, employer ETPs up to the RBL are taxed concessionally (depending on the components), and only benefits exceeding the RBL are taxed at the top marginal tax rate. The proposed tax structure is likely to result in significantly higher taxation than is the case under the current set of rules.

The FPA notes that the $140,000 threshold was chosen because it roughly equates to what the current post '83 low rate threshold for persons age 55 and over would be at the time the proposal is due to take effect (taking account of indexation).

However, the FPA believes that consideration needs to be given to a higher limit being imposed before the top marginal tax rate applies. As a suggestion, the first $140,000 could be taxed as proposed, the next $360,000 at 30%, and the excess at the top marginal rate. The resultant $500,000 limit would be in line with the CGT exempt threshold for small businesses. These thresholds should then be subject to indexation.

In the past, people who had received employer ETPs had been able to either receive them directly or to roll them over into superannuation. Employer ETPs were potentially a significant source of superannuation savings. However, the combined effect of the inability to rollover employer ETPs and the proposed taxation treatment, is that this money will be lost to retirement savings. There would be little point in contributing to superannuation what is left of the employer ETP after tax. This is demonstrated by the case studies in Attachment A.

Under the proposed plan, employer ETPs will not be able to be rolled over from 1 July 2007, but it appears that the Government intention is not to stop small business owners who create a CGT exempt component upon sale to roll this ETP over. If correct, when drafting legislation care should be taken to ensure that ETPs comprised of a CGT exempt component can still be rolled over to superannuation.

Recommendation
A higher limit should be imposed before the top marginal tax rate applies. As a suggestion, the first $140,000 could be taxed as proposed, the next $360,000 at 30%, with the excess taxed at the top marginal rate.

The FPA recommends that the choice to either rollover employer ETPs to superannuation, or to take them as a cash lump sum should be retained.

DISCRIMINATION AGAINST SELF EMPLOYED FOR TPD PAYOUTS

Self employed people are disadvantaged by the current taxation treatment of total and permanent disability (TPD) payments paid from a superannuation fund. When paying out a TPD benefit from superannuation, the taxation treatment largely depends on the age of the member, and whether the member is eligible for the Post June 1994 Invalidity component. A Post June 1994 Invalidity component is one of the eligible termination payment (ETP) components. It is tax free when withdrawn as a lump sum from a superannuation fund and currently does not count towards a member's RBL.

It is clear that self employed people are disadvantaged by the eligibility rules for the Post June 1994 Invalidity component. A member must satisfy three conditions before they will be eligible to have a Post June 1994 Invalidity component included in their ETP:

1. The payment must be made in consequence of terminating employment;
2. The termination of employment must be before the normal retirement date of the person with reference to their age and period of service; and
3. Two legally qualified medical practitioners must certify that the person's disability is likely to result in the person being unable to be employed in a capacity for which they are reasonably qualified by their education, training or experience.

If a member meets each of the above three conditions then they will be able to receive an ETP that includes an invalidity component. One difficulty that is commonly encountered in satisfying the three conditions is in regards to the initial condition of terminating employment. For self employed individuals who are not employed in companies (i.e. are employed as sole traders or in partnerships) and for those that are unemployed (i.e. undertake home duties), there will clearly be significant difficulty in satisfying this condition. Consequently, when they receive a TPD payment paid as a lump sum from a superannuation fund they will not receive the Post June 1994 Invalidity component and may be taxed on the benefit they receive (depending on the person's age and the ETP components that are paid).

This creates inequity between sole traders and people who are employees. It also creates inequity between a person operating a business as a sole trader, and a person who has incorporated to operate their business under a company structure.

The case studies in Attachment B demonstrate how the factors of age and eligibility to receive a Post June 1994 Invalidity component affect the taxation of TPD benefits paid as a lump sum from a superannuation fund.

Recommendation
As recommended in the report "Improving the Superannuation Savings of People Under 40", the tax treatment of the unincorporated self employed should be aligned with that accorded the incorporated self employed. Therefore the termination of employment should extend to include any gainful employment situation, including a sole trader or partnership arrangement.

TRANSFERRING SUPERANNUATION BENEFITS

The FPA considers it important that once a member decides to transfer benefits between superannuation funds, this occurs more quickly than is often the case at present.

The FPA's members, in advising their clients, are often frustrated by what seems to be unwarranted delays. Funds, and their administrators in some cases, seem to take advantage of the current 90 day statutory period. Therefore in principle we support the proposed 30 day period which aligns with discussions the FPA has been having with IFSA and ASFA on the need for commonly required information on a client's current superannuation fund to be readily available. The FPA would be willing to co-operate with the development of new procedures, and administration and advice forms to complement the new policy period.

The FPA acknowledges that there are legitimate cases where it may take longer than the 30 day period for its members, their clients, and the funds to obtain the necessary documentation and advice to comply. One example of this may be where the identity of the member is required at the time of payment, usually because in the case of a standard employer sponsored member the employer has provided the bare minimum identity information of the employee sufficient to meet SG requirements. (In noting this, the FPA is not calling for more information to be provided by the employer at the commencement of the membership of an employee, as this may introduce other inefficiencies into the superannuation system and complexity for employers. This is at a time when employers are having to comply with the demands of quarterly SG payments and are overlaid by Choice of Fund requirements.) Other examples include instances where incorrect or incomplete forms are sent in by the member, where the fund is aware that not all contributions have been paid for the member, or where the member's insurance arrangements require further information.

Recommendation
A 30 day period apply only when the relevant superannuation fund has all the information it requires to process the request for transfer. This provision should be accompanied by a requirement that the relevant fund advise the member within the 30 day period why it is unable to process their request, what information is required, and the steps taken to acquire the information.

DISCRIMINATION AFFECTING SEVERELY DISABLED PERSONS

Currently there is an anomaly in the Superannuation Regulations Section 6.01 (2) that prevents some individuals who have suffered disabilities from accessing the benefits of the superannuation framework. The anomaly results in discrimination against severely disabled people, predominantly against people who have acquired their disability at a young age.

While the age and work requirements for contributions to superannuation have been removed, Section 6.01 (2) prevents the release of the funds until the normal retirement age, and hence access to allocated pensions irrespective of permanent incapacity, only for those who have never commenced gainful employment.

The major challenge in the case of these individuals is to make the available funds last to provide high quality care and the best achievable quality of life over the lifespan of the person affected. The difference between normal tax rates that these individuals are subject to now and allocated pensions can make a difference of as much as 20 years in their ability to meet their required care and lifestyle needs.

Recommendation
The wording of Section 6.01(2) be changed to remove the requirement of prior gainful employment to "permanent incapacity, in relation to a member where the trustee is reasonably satisfied that the member is unlikely, because of ill-health, to ever engage in gainful employment for which the member is reasonably qualified by education, training or experience; or in the case of a member who has not commenced gainful employment, ever attain capability for gainful employment".

SUMMARY OF RECOMMENDATIONS

UNDEDUCTED CONTRIBUTIONS

Remove the work test requirement for persons aged between 65 and 74 years of age in respect of undeducted contributions.

When making an undeducted contribution under the averaging rule, a person should only be required to meet the work test in the year in which the contribution is made.

A transitional arrangement allowing undeducted contributions of "three times the proposed (transitional) concessional contributions limit" should be implemented. In practice this would permit undeducted contributions of $300,000 to be made to superannuation each year up until 30 June 2012. Implementing the averaging rule would then allow a $900,000 undeducted contribution to be averaged over three years.

The $150,000 cap for undeducted contributions should be allowed to be averaged over five years. This would better reflect the sums of money generally involved in retirement strategies involving large one off contributions.

The FPA recommends the definition of the CGT exempt component be extended. It should continue to allow a conversion of up to $500,000 of taxable capital gains into an eligible termination payment. But it should also allow the conversion of the total sale proceeds into an eligible termination payment (as a tax free component) which can then be rolled into superannuation and will not be counted as part of the limit on undeducted contributions.

DEDUCTIBLE CONTRIBUTIONS

The transitional allowance for over 50s to contribute $100,000 per annum be extended indefinitely so in fact two thresholds will operate; $50,000 for under 50s, and $100,000 for over 50s. This will ensure superannuation savings over time are more closely matched to the savings capacity of the individuals for whom the contributions are made. This proposal is based on a realistic assessment of people's ability to save for their retirement and would retain the superannuation system's simplicity.

The contribution rule should be amended to allow non-mandated employer contributions from age 70-74 (inclusive).

INDEXATION

Introduce a system of indexation for the limits on concessional deductible contributions and undeducted contributions, so that the real value of the limits are maintained and people continue to be encouraged to make full use of the superannuation system.

COMMUTATION OF PENSIONS

Allow term allocated pensions (market linked income streams) to be commuted at the discretion of the fund manager.

Consult with life insurance companies to determine if an option will be granted to allow lifetime and term certain income streams to be commuted. The consultation needs to take into account the financial impact on capital requirements. In many cases, due to the commutation values, clients may choose not to commute even if the option is made available.

Allow defined benefit pensions paid from SMSFs to be commuted to the new type of pension.

Any option to commute (as cash or rollover to another income stream) should only be allowed for a fixed window of 12 months from announcement of the decision. This would allow advisers and product providers time to review systems and client accounts.

If commutations are made in this period, there should be no claw back permitted of social security benefits or any taxation reassessments.

NEW PENSIONS

The FPA recommends that pensions and annuities with residual capital values should continue to be available after 1 July 2007.

The FPA recommends Guaranteed Lifetime Pensions or Annuities offered by superannuation funds or life companies should continue to be available.

DEATH BENEFITS

The SIS definition of dependant should also apply for tax and anti-detriment purposes.

The FPA recommends that all SIS dependants should retain the option of receiving death benefits in the form of a lump sum, pension or a combination of both (subject to fund rules). Also, trustees should not be prevented from paying death benefits to multiple beneficiaries if they are dependants for SIS purposes.

For simplicity and equity, the FPA recommends that the tax rate on the taxable component be limited to 16.5%, even if this includes an insurance component paid through superannuation. At a minimum, the FPA asks for clarification on the issue of taxation treatment for superannuation death benefits paid to a non-tax dependant.

As recommended above, if the tax definition of dependant were aligned with the SIS definition, then this would significantly reduce the level of complexity. Providers of superannuation funds as well as financial advisers then would not need to concern themselves with components beyond age 60.

EMPLOYER ELIGIBLE TERMINATION PAYMENTS

A higher limit should be imposed before the top marginal tax rate applies. As a suggestion, the first $140,000 could be taxed as proposed, the next $360,000 at 30%, with the excess taxed at the top marginal rate.

The FPA recommends that the choice to either rollover employer ETPs to superannuation, or to take them as a cash lump sum should be retained.

DISCRIMINATION AGAINST SELF EMPLOYED FOR TPD PAYOUTS

As recommended in the report "Improving the Superannuation Savings of People Under 40", the tax treatment of the unincorporated self employed should be aligned with that accorded to the incorporated self employed. Therefore the termination of employment should extend to include any gainful employment situation, including a sole trader or partnership arrangement.

TRANSFERRING SUPERANNUATION BENEFITS

A 30 day period apply only when the relevant superannuation fund has all the information it requires to process the request for transfer. This provision should be accompanied by a requirement that the relevant fund advise the member within the 30 day period why it is unable to process their request, what information is required, and the steps taken to acquire the information.

DISCRIMINATION AFFECTING SEVERELY DISABLED PERSONS

The wording of Section 6.01(2) be changed to remove the requirement of gainful employment prior to permanent incapacity.

ATTACHMENT A

CASE STUDIES ON THE IMPACT OF PROPOSED TREATMENT OF EMPLOYER ETPS

Case Study 1
Current rules apply
Assume all money is post June 1983 untaxed element
$600,000 employer ETP payable

1. Aged 54
$600,000 @ 31.5% = $189,000

Total benefit received after tax has been deducted = $411,000

2. Age 55
First $135,590 @ 16.5% = $22,372.35
Balance ($464,410) @ 31.5% = $146,289.15

Total benefit received after tax has been deducted = $431,338.50

Case Study 2
Proposed Budget rules apply
Assume all money is taxable component
$600,000 employer ETP payable

1. Aged 54
First $140,000 @ 31.5% = $44,100
Balance ($460,000) @ 46.5% = $213,900

Total benefit received after tax has been deducted = $342,000

2. Age 55
First $140,000 @ 16.5% = $23,100
Balance ($460,000) @ 46.5% = $213,900

Total benefit received after tax has been deducted = $363,000

ATTACHMENT B

CASE STUDIES ILLUSTRATING TPD PAYOUT ISSUES FOR SELF EMPLOYED

Sum insured: 1 million
Date policy commenced: 30 June 2001
Date TPD event occurs: 30 June 2006
Normal date of retirement: Age 65

Case Study 1 – Self employed person (sole trader) under current superannuation rules

Aged under 55 (Age 40) Date of Birth – 30/6/1966	Aged 55 Date of Birth – 30/6/1951
- will not be eligible for the Post June 1994 Invalidity Component - therefore all of the ETP will be taxable **RBL** Discounted - $423,843 **ETP Components** Post 83 taxed - $423,843 Excessive - $576,157 **Taxation** Post 83 Taxed $423,843 @ 21.5% = $91,126 **Excessive** $576,157 @ 39.5% = $227,582 **Total benefit** received after tax has been deducted = $681,292	- will not be eligible for the Post June 1994 Invalidity Component - therefore all of the ETP will be taxable **RBL** Flat Dollar - $678,149 **ETP Components** Post 83 taxed - $678,149 Excessive - $321,851 **Taxation** Post 83 Taxed First $135,590 tax free Balance ($542,559) @ 16.5% = $89,522 **Excessive** $321,851 @ 39.5% = $127,131 **Total benefit** received after tax has been deducted = $783,347

Case Study 2 – Employee under current superannuation rules

Aged under 55 (Age 40) Date of Birth – 30/6/1966	Aged 55 Date of Birth – 30/6/1951
- assuming they are eligible for Post June 1994 Invalidity Component **RBL** Discounted - $423,843 **Post June 1994 Invalidity Component** 1,000,000 x 9132 / 10958 = $833,363 **Other ETP Components** Post 83 taxed - $166,637 Excessive - NIL **Taxation** Post 83 Taxed $166,637 @ 21.5% = $35,827 **Total benefit** received after tax has been deducted = $964,173 **The Post June 1994 Invalidity component counts towards a person's undeducted purchase price which is used to calculate the tax free portion of an income stream (i.e. the deductible amount).*	- assuming they are eligible for Post June 1994 Invalidity Component **RBL** Flat Dollar - $678,149 **Post June 1994 Invalidity Component** 1,000,000 x 3654 / 5480 = $666,788 **Other ETP Components** Post 83 taxed - $333,212 Excessive - NIL **Taxation** Post 83 Taxed First $135,590 tax free Balance ($197,622) @ 16.5% = $32,607 **Total benefit** received after tax has been deducted = $967,393 **The Post June 1994 Invalidity component counts towards a person's undeducted purchase price which is used to calculate the tax free portion of an income stream (i.e. the deductible amount).*

** Please note that RBLs are determined using the 2006/2007 financial year figures.*

Case Study 3 – Self employed person (sole trader) with no RBLs

Aged under 55 (Age 40) Date of Birth – 30/6/1966	Aged 55 Date of Birth – 30/6/1951
- will not be eligible for the Post June 1994 Invalidity Component - therefore all of the ETP will be taxable **ETP Components** Post 83 taxed - $1,000,000 **Taxation** Post 83 Taxed $1,000,000 @ 21.5% = $215,000 **Total benefit** received after tax has been deducted = $785,000	- will not be eligible for the Post June 1994 Invalidity Component - therefore all of the ETP will be taxable **ETP Components** Post 83 taxed - $1,000,000 **Taxation** Post 83 Taxed First $135,590 tax free Balance ($864,410) @ 16.5% = $142,628 **Total benefit** received after tax has been deducted = $857,372

Case Study 4 – Employee with no RBLs

Aged under 55 (Age 40) Date of Birth – 30/6/1966	Aged 55 Date of Birth – 30/6/1951
- assuming they are eligible for Post June 1994 Invalidity Component **Post June 1994 Invalidity Component** 1,000,000 x 9132 / 10958 = $833,363 **Other ETP Components** Post 83 taxed - $166,637 **Taxation** Post 83 Taxed $166,637 @ 21.5% = $35,827 **Total benefit** received after tax has been deducted = $964,173 **The Post June 1994 Invalidity component counts towards a person's undeducted purchase price which is used to calculate the tax free portion of an income stream (i.e. the deductible amount).*	- assuming they are eligible for Post June 1994 Invalidity Component **Post June 1994 Invalidity Component** 1,000,000 x 3654 / 5480 = $666,788 **Other ETP Components** Post 83 taxed - $333,212 **Taxation** Post 83 Taxed First $135,590 tax free Balance ($197,622) @ 16.5% = $32,607 **Total benefit** received after tax has been deducted = $967,393 **The Post June 1994 Invalidity component counts towards a person's undeducted purchase price which is used to calculate the tax free portion of an income stream (i.e. the deductible amount).*