Institute of Actuaries of Australia

5 July 2006

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

Dear John

Members of the Institute's Superannuation Tax Reform Task Force and Superannuation and Employee Benefits Practice Committee appreciate the opportunity to have met with you and Trevor last week in Sydney. The purpose of this letter is to respond to your request for early identification of the Institute's priority issues.

We are conscious also of your desire to receive submissions as soon as possible and we plan to give you the bulk of our submissions later this week and the remainder next week.

In considering priorities, we understand your desire for us to classify each submission topic according to the following:

- whether it is in the Plan and central to it;
- in the Plan but not central;
- not in the Plan (and therefore on a 'wish list');
- whether it affects the short term versus the longer term and
- whether we regard it as being of high importance or urgent versus a 'nice to have'.

We have identified nine items on which we intend making submissions. These are –

Topic 1 Administering Contribution Limits

Topic 2 Contribution Limits and Defined Benefit Funds

Topic 3 Indexation of Contribution Limits

Topic 4 Appropriateness of Contribution Limits

Topic 5 Death and Disability Issues

Topic 6 Tax Rates on Fund Investment Income

Topic 7 Voluntary Deductible Contributions for Employees

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Topic 8 The Minimum Pension Scale

Topic 9 Issues Affecting the 60 to 65 Age Group

It is difficult to classify these topics in clear order of priority and we have not explicitly evaluated each of our proposals against your preferred classification criteria, for we think your own evaluation is probably more appropriate than ours. Nevertheless we wish to note that we regard –

- Topics 1 and 2 as essential to the effective implementation and administration of the Treasurer's Plan

- Topics 3, 4 and 5 as of high importance in relation to confidence of the community in superannuation, including some matters of simplicity and some matters that facilitate administration and financial planning

- Topics 6 and 7 as of high importance because of the substantial opportunity that our proposals in these submissions would create for simplification and improved equity

- Topics 8 and 9 as being worthy of serious consideration at this stage. Topic 8 is a relatively simple matter and whatever is decided now is likely to remain in force for quite a long time. Topic 9 is one that deals with what we see as anomalies in the proposals, but we acknowledge that these anomalies may be difficult to resolve within the overall context of the Plan.

As well as regarding Topics 1 and 2 as essential, we believe that each of Topics 3 to 7 should be considered and dealt with now, as part of the new and radically different superannuation regime that you are implementing. Although it may be possible to defer consideration of them and introduce them later, in our eyes each of our proposals on these topics would make a highly valuable contribution to the new regime. We believe the opportunity to work them through and include them in the new legislation should not be passed up now.

You may also be interested to know that the taskforce has also prepared a further paper entitled "Tax-free superannuation benefits: a future revenue problem?" This paper is not a submission but a commentary on the Treasurer's Plan, and has been prepared for our members and other interested parties. We will send you a copy when the paper is released.

Yours sincerely

Philip French
Director
Public Affairs

Institute of Actuaries of Australia

5 July 2006

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

Dear John

**A Plan to Simplify and Streamline Superannuation –
Our First Submission: Administering Contribution Limits**

The attachment to this letter is the first of a number of submissions that the Institute will be making in response to the invitation to comment on the Plan.

This submission relates to the administration of the annual limits for deductible contributions and undeducted contributions for superannuation fund members.

The Institute has made this submission its first one because of the importance we place on this issue. The proposal in the Treasurer's Plan is that superannuation funds and the ATO take responsibility for monitoring the deductible contribution limit and, in cases where the limit is exceeded, paying contributions tax at 45% instead of 15%.

We believe this method will prove to be an uneconomic and inefficient way of monitoring the contribution limits and collecting tax. This submission puts forward an alternative approach which would simplify and allow the effective administration and monitoring of the contribution limits.

The Institute believes that its approach has numerous advantages, as outlined in the submission. It would also maintain and perhaps even facilitate the integrity of the Treasurer's Plan regarding contribution limits.

I would be happy to arrange for the members of our Task Force to discuss this submission with you at your convenience.

Yours sincerely

M A Stevenson
President

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The Treasurer’s Superannuation Plan - IAAust Submission

Topic 1- Administering Contribution Limits

The Submission Topic

This submission relates to the administration of the annual limit of deductible contributions and undeducted contributions for each member.

Arrangements proposed in the Treasurer’s Plan

In summary under the proposed new arrangements:

- Employers will be able to obtain full deductions in respect of all contributions paid to superannuation funds for their employees;
- Self employed people will be able to claim tax relief on all contributions paid to their personal accounts in superannuation funds which members have nominated as deductible;
- Superannuation funds will treat all such contributions as taxable contributions, and will pay 15% tax on each member’s contributions up to $50,000 in any year, and 45% on contributions in excess of $50,000;
- The $50,000 limit applies to the aggregate of all deductible contributions paid for or by the member to all funds;
- A $150,000 a limit applies to the aggregate of all undeducted contributions with the ability to average this limit over three years.

Administrative Arrangements in the Treasurer’s Plan

From the point of view of any superannuation fund, it is always possible that contributions will have been paid to more than one fund, so that no individual fund can be certain whether to levy 15% or 45% tax on the contributions it receives from employers or the contributions from self employed people claiming deductions.

The proposal in the Treasurer’s Plan is that superannuation funds and the ATO take responsibility for monitoring the deductible contribution limit and, in cases where the limit is exceeded, paying contributions tax at 45% instead of 15%. We understand that the details of the administration arrangements for the payment of contributions tax are to be determined in consultation with the superannuation industry. However if the ATO and funds are responsible for the monitoring and the administrative arrangements follow previous precedents then they are likely to include:

- Funds advising the ATO and the member of the total taxable contributions paid in respect of the member after the end of each tax year, tagged with the member’s TFN, and summarised according to who paid them;
- The ATO determining the fund or funds where part of (or the whole of) the contributions for each member exceeding the $50,000 limit should attract the 45% tax – possibly part of those paid to the fund receiving the largest

contribution for the year (and if more than one fund applies, then the next largest);

- The ATO advising both the funds and the member the amounts of the contributions to which the higher 45% tax should be applied;
- Funds levying the 45% tax in the relevant cases;
- Funds treating deductible contributions paid in excess of the limit as undeducted;
- Funds possibly providing individual advices to members;
- The ATO re-assessing the members undeducted limit position and if required requesting the Fund to repay excess contributions to the member;
- Funds returning any excess undeducted contributions to the member;
- The ATO making arrangements to resolve any differences between superannuation contribution deduction claims and those advised by superannuation funds.

Comment on Approach

If this approach is taken we believe the last aspect above will give rise to many difficulties both to funds and companies, especially those with a financial year ending on a date other than 30 June. Members making personal deductible contributions who have been both employed and self employed at various times during a year can also give rise to queries (as happens now).

As all of the reporting events need to occur after the end of the tax year, time delays will create added complexity (and delays could easily be two years or more). The superannuation surcharge operated on a similar basis and was found to be extremely complex to administer by both funds and the ATO as members have often moved their benefits to other funds before the assessment has reached the original fund.

From a member's perspective the proposed process will not be transparent. Additional tax may be assessed and paid from the member's superannuation account without instruction from the member and possibly without reporting to the member at the time of the transaction.

The arrangements are very complex and relate to all members yet they will affect a very small portion of members as few members are likely to pay contributions in excess of the $50,000 limit. The process is therefore unduly burdensome on the ATO and also superannuation funds, and therefore costly for members, most of whom are not affected by the limits. We believe it will be an uneconomic and inefficient way of monitoring the limits and collecting tax.

Suggested Alternative Approach

We propose an alternative administrative approach that will be transparent to members and which, if required, could easily be amended to provide options to members for payment of any additional tax and refund of any excess undeducted contributions.

We propose that all superannuation contributions paid by an employer on behalf of an employee be recorded on the employee's pay slips and PAYG payment summary certificates as superannuation contributions of the employee (employers are already required to report SG payments to members). No tax would be deducted from the contributions. The reporting could be similar to the arrangements for Fringe Benefits.

- Employers would provide certificates to each member shortly after the end of the tax year for contributions paid in respect of the member on the PAYG payment summary certificate.
- Members would submit the contribution certificates with their tax returns as part of the annual tax return assessment.
- Members would record all undeducted superannuation contributions and the funds to which they were paid on their tax return.
- Where more than the $50,000 limit for deductible contributions has been paid by or for a member (including any contributions as a self-employed person), the excess would be treated as taxable income (with a rebate for the 15% tax already paid by the fund). If preferred the proposed 45% tax rate could be imposed (less the 15% rebate).
- Any excess deductible contributions would be included in the calculation to assess the maximum undeducted limit. Only if this limit was exceeded would the ATO instruct a refund of contribution to the member from a fund (possibly with some penalty applied).

This approach will impose a tax liability on members who have not monitored their contributions in relation to the $50,000 deductible limit. While these employees may prefer to meet any additional tax via their superannuation fund, to do so would introduce further complexity. These members will be amongst the wealthier so that any additional tax should be manageable.

Advantages of the suggested alternative approach

- The method will be fully transparent to members.
- It would create more awareness by members of their contributions (and their superannuation generally).
- Funds will not need to report contributions and tax file numbers for all members when in practice very few members will be required to pay additional tax. There will be no additional administration for superannuation funds.
- The ATO will not need to match all fund contributions to members via tax file numbers. There will be no special administration aspects for the ATO once the changes are implemented.
- The exercise will form part of the annual personal tax return and will therefore be performed more promptly than if reporting is required via superannuation funds with a subsequent matching of tax file numbers.

- From the employer's perspective the source of the superannuation contributions will be made clearer to members. As employers already have to provide PAYG statements, and there are requirements to report SG contributions on pay slips, it is not an undue burden for the employer to report all superannuation contributions on pay slips. There will be no additional administration for employers once the payroll system is amended to include all superannuation contributions in place of SG contributions:
- All taxable contributions will be taxed at 15% in the fund (with no need for the proposed 45% rate).
- Excess contributions may be taxed at either the proposed 45% or at the member's marginal rate if this is considered fairer for taxpayers with incomes below the new $150,000 threshold for the 45% rate.
- The approach would deal easily with individuals who were both employees and self- employed for parts of the same tax year.
- There would be reduced need for communications between funds and the ATO (although the ATO may still choose to monitor superannuation contributions in respect of all taxpayers).
- All processes can be automated.
- The method facilitates correct monitoring of the $150,000 limit for undeducted contributions (see below).

From a Treasury perspective, an important advantage may be the additional flexibility provided in being able easily to accommodate future changes (e.g. capping of deductibility or converting to a rebate system), which may be introduced to suit a future government revenue or equity objectives.

Monitoring of Undeducted Contributions

We believe that it would be possible for high income earners to circumvent the $150,000 undeducted contribution limit under the Treasurer's current proposal. Our alternative proposal for deductible contributions, described above, would rectify this anomaly:

> It appears that a high income earner paying the top marginal tax rate who wanted to circumvent the $150,000 undeducted contribution limit could do the following:
>
> 1. Contribute any amount above $50,000 to superannuation by salary sacrifice. The first $50,000 is deductible and the balance attracts tax at 45%. For example, if the contributions were $150,000 (or say $1,050,000), there would be excess contributions of $100,000 (or $1,000,000) before contributions tax and $55,000 (or $550,000) after contributions tax.
> 2. Make an undeducted contribution of $150,000, as the excess deductible contribution doesn't appear to revert to a non-deductible contribution.

In effect this individual will have made the equivalent of $205,000 (or $700,000) in undeducted contributions, thus circumventing the limit (and incidentally saving the 1.5% Medicare levy on the excess contributions).

Under our alternative approach for deductible contributions, if the excess deductible contributions are automatically treated as undeducted contributions, the ATO can apply them against the $150,000 limit, and thereby appropriately monitor the limit for undeducted contributions simultaneously with the limit for deductible contributions.

Defined Benefit Funds

The Institute is confident that a simple method of determining notional contributions for defined benefit funds can be designed, and we will be making a separate submission on this aspect.

The criteria set for the establishment of these notional rates are as follows:

- It should be possible for members to determine their defined benefit deductible contributions in advance so they can plan any additional contribution program.
- The rates should remain in force unless new rates are required to reflect benefit changes.
- The operation of the rates needs to be simpler than the surcharge regime
- There needs to be a sensible balance between equity and complexity tempered by the recognition that the number of members who now have defined benefits is relatively small.
- Any opportunities for manipulating the system need to be identified.

Institute of Actuaries of Australia

7 July 2006

Mr J Lonsdale
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The Treasury,
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PARKES ACT 2600

Dear John,

A Plan to Simplify and Streamline Superannuation –
Our Second Submission: Contribution Limits and Defined Benefit Funds

The attachment to this letter is the second of a number of submissions that the Institute is making in response to the invitation to comment on the Plan.

This submission relates to the administration of the annual limits for deductible contributions in respect of defined benefit superannuation fund members.

The Institute believes that this important issue can be dealt with much more simply than under the surcharge regime. If so, it would be advantageous to employers and trustees operating defined benefit plans and would provide greater certainty and transparency for employees.

This submission puts forward three criteria against which the effectiveness of any approach should be assessed, suggests a number of approaches which could be adopted and makes a recommendation regarding our preferred approach.

I would be happy to arrange for the members of our Task Force to discuss this submission with you at your convenience.

Yours sincerely

M A Stevenson
President

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The Treasurer's Superannuation Plan - IAAust Submission

Topic 2- Contribution Limits and Defined Benefit Funds

The Submission Topic

This submission relates to the administration of the annual limits for deductible contributions in respect of defined benefit superannuation fund members.

In defined benefit funds, the level of employer contribution does not always reflect the value of employer support accruing to each individual member. To assess the level of employer support for the purpose of the surcharge, a complex system for actuarial certification of Notional Surchargeable Contribution Factors (NSCFs) was developed. Even simple defined benefit funds needed complex sets of tables of NSCFs which commonly had to be revised every few years or alternatively calculations were carried out regularly for each individual member of the fund. The complexity involved created substantial cost and inconvenience for funds, and considerable uncertainty for employees.

Criteria for Judging the Effectiveness of Preferred Approach

The wide range of different types of defined benefit funds and the range of circumstances of individual members means that any "theoretically correct" approach to determining "notional" contributions in a defined benefit fund involves complex calculations by actuaries. However, the Institute is confident that a simple method of determining notional contributions for defined benefit funds can be designed.

To assess the effectiveness of the various approaches which could be considered we have set out three criteria. We consider that criterion 1 is of paramount importance.

1. **Certainty -** It should be possible for employees to determine their level of employer support in advance so that they can plan confidently any voluntary deductible contributions in relation to the $50,000 limit on deductible contributions.

2. **Simplicity -** It should be much simpler than the approach specified for the surcharge under SCR97/1, i.e. it should not require multiple pages of tables or require new contribution rates to be developed unless the underlying benefit formula changes.
3. **Equity -** The degree of "equity" and complexity should be consistent with the fact that very few defined benefit members will have levels of employer support even approaching $50,000. However, any opportunities for manipulation should be identified.

Possible Approaches

Individual rates - The approach used for the NSCFs for the surcharge involved making actuarial estimates of the long term cost, expressed as a percentage of salary, of providing the benefits in each fund, for each type of member, using assumptions specified by the ATO. In practice this meant most funds had a different rate for every benefit category, age, duration of service and gender of member. Apart from the complexity of this approach, members were usually not aware of the various contribution rates and, therefore, were not able to estimate their surchargeable contributions with any confidence.

Increase in benefit - Measuring the increase in the member's vested benefit over the year, and adjusting this for the effect of member undeducted contributions and investment income on the opening balance, could be seen to be an equitable measure of the level of employer support for each member. However, this approach comprehensively fails to meet criterion 1 above as it cannot be determined until the end of each year, and the adjustments required mean that it probably fails to meet criterion 2.

Single rate – It is possible to calculate, for any category of benefits, a single estimate, expressed as a percentage of salary, of the long term cost of providing benefits, which could be applied across all members of that benefit category, and which would not need to be recalculated unless the benefit design is changed. Once members are advised of the percentage that applies to them, they are in a similar position to accumulation fund members as regards planning to remain within the deductible contribution limits. This approach would meet criteria 1 and 2 above, and would generally meet criterion 3.

Recommended Approach

The single rate approach described above, being a single rate for each category of benefits, is our strong preference and it is described in more detail below, including a more thorough assessment against the three criteria.

Many defined benefit funds have a simple design with a uniform benefit accrual rate for retirement benefits. For example the benefit may be 15% of Final Average Superannuable Salary for each year of fund membership. If all funds were this simple, the single rate could be set at the uniform accrual rate, less the rate of member contributions.

In reality, the majority of funds have one or more complicating factors which mean that such an approach is either not able to be determined or would result in different designs having the same rate, thus failing a simple test of equity. "Complicating factors" which are relatively common include:

- Accrual rates which change with age or service;
- Caps on benefits;
- Designs which have material differences between benefits payable on retirement and on resignation;
- Member contribution rates which are not a simple percentage of salary;
- Different definitions of Final Average Superannuable Salary;
- Benefits which are determined as the greater of the benefits calculated using two (or more) quite different formulae; and
- Funds which provide members with options regarding the form or timing of their benefit, such as pension options.

Therefore, to calculate a single rate for each category of benefits, actuarial calculations will be required initially, and also if and when benefits are subsequently modified. We propose that the process for this approach be as follows:

- Each fund obtains an actuary's certificate effective at 1 July 2007 stating the single notional contribution rate for each benefit category.

- This rate must be notified by the fund to each affected member and to the employer(s) of those members.

- The notional contribution rate would be calculated using standard actuarial assumptions and methodology determined by the Australian Government Actuary (AGA). Unlike the approach under SCR97/1 the rate generally would not be dependent on any assumption used by the actuary for the specific fund, although for some complex designs it may be necessary for some additional demographic assumptions to be used. (These could be prescribed as being those used for the most recent actuarial investigation prior to 1 July 2007).

- The rate would remain unchanged for the duration of each member's period of membership, unless the underlying benefit formulae are changed in a way which would increase or decrease the value of the benefits. In those circumstances the fund must obtain a recertification of the rate by an actuary.

Relative to the approach used for the surcharge under SCR97/1 this approach is much simpler, does not normally require expensive ongoing recalculations, does not rely on assumptions which can vary from actuary to actuary and can be used by fund members to plan their deductible contributions in advance. It satisfies, therefore, the criteria of "certainty" and "simplicity".

From an equity perspective, some members will possibly view the single rate as being too high (or too low) relative to the value of their benefits in their specific circumstances. This should be viewed in the context that, even with a notional contribution rate of 20% of salary, a member would need to have a salary of $250,000 p.a. to be affected. Combined with the declining number of members with defined benefits, this means the number of members affected by these rates will be very small and will generally be among the group who are the largest beneficiaries of the government's proposed reforms. In addition, we expect many closed defined benefit funds to provide opportunities for members to voluntarily transfer to accumulation arrangements. This means that members who feel that the notional contribution rate adversely affects their position would commonly be able to transfer to alternative arrangements.

Integrity of Approach

The remaining consideration under the "equity" criterion is the ability for the single rate approach to be manipulated. As with other measures in the proposed reforms, it will be necessary to balance the desire to achieve genuine simplification with the desire to avoid abuse.

Because the actuarial methodology and key assumptions are fixed in advance by the AGA and the single rate reflects the actual benefit design of the fund, there are some controls in place. The requirement for the rate to be changed when benefit formulae change also acts as a control. Also, protection is provided by the fact that the calculations will be carried out by actuaries who are members of a profession with high ethical standards. Actuaries are bound by the Institute's Code of Professional Conduct, and in addition the Institute will ensure that guidance is provided to its members in respect of the calculation of the single rate.

Furthermore, it should be noted that there are already several measures in place which could be used to monitor the use of defined benefit funds to provide benefits which aim to circumvent the limits. For example, funds with less than 50 defined benefit members are generally not permitted to accept new defined benefit members. Defined benefit funds are also subject to actuarial certification in respect of funding and solvency which would allow increases in benefits to be identified.

On balance we are confident that the "single rate" approach can be adapted to reduce the risk of manipulation or abuse.

Institute of Actuaries of Australia

20 July 2006

Mr J Lonsdale
General Manager
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Langton Crescent,
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Dear John,

A Plan to Simplify and Streamline Superannuation –
Our 3rd Submission: Indexation of Contribution Limits

The attachment to this letter is the 3rd of a number of submissions that the Institute will be making in response to the invitation to comment on the Plan.

This submission relates to the indexation of the annual limits for deductible and undeducted contributions.

The Institute believes that these dollar limits should be indexed to maintain their value in real terms, for the reasons explained in the submission, and that some form of rounding should be used to keep the amounts simple.

I would be happy to arrange for the members of our Task Force to discuss this submission with you at your convenience.

Yours sincerely

M A Stevenson
President

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The Treasurer's Superannuation Plan - IAAust Submission

Topic 3- Indexation of Contribution Limits

The Submission Topic

This submission relates to the indexation of the annual limits for deductible and undeducted contributions.

The Plan to Simplify and Streamline Superannuation proposed annual limits of $50,000 in respect of deductible contributions and $150,000 in respect of undeducted contributions. The Plan was silent on the matter of indexation of these limits.

There are two questions to consider –

1. How important is it to index the limits?

2. If there is to be indexation, what method or technique should be used?

1. How important is it to index the limits?

It is self-evident that the contribution limits will progressively depreciate in real value if they are not indexed in some way.

The superannuation industry, including many fund members, is accustomed to indexation, and for good reason. Not only is indexation a well established feature of the current system, but indexation of contribution limits is also one of the essential ingredients of a system that facilitates or encourages adequate benefit levels.

If there is to be no automatic indexation of the new limits, depreciation of the real value of the limits will undoubtedly generate a continuing obligation on the government to consider ad hoc adjustments from time to time to restore real value (in the interests of benefit adequacy). In our view, it is preferable that the process be automated (through an indexation formula or technique that is applied regularly).

To not provide automatic indexation would seem to be inconsistent with precedents set within the current system and may also compromise one of the goals that Treasury has expressed, namely the goal of encouraging adequate benefits in retirement. It also has the potential to diminish confidence in the system.

Recommendation: we submit that contribution limits should be indexed.

2. What method or technique should be used to index the limits?

There are three elements of indexation, the indexation interval, the index to be used and the calculation method.

Indexation Interval

The Institute believes that *annual* indexation in line with an objective, published benchmark should be applied to provide greater certainty and transparency for participants.

We advocate annual indexation on 1 July each year.

The Index

For the indexation at 1 July each year of most comparable limits (maximum deductible limits, surcharge thresholds, Superannuation Guarantee Minimum Earnings Base etc) the annual change in Average Weekly Ordinary Time Earnings (AWOTE) to the March quarter has been used. This index is well known and easily available. Its rate of increase is widely regarded as an indicator of the growth in community living standards and this makes it suitable for the indexation of amounts relevant to retirement incomes.

Calculation Method

We recognise that the precise use of AWOTE leads to dollar amounts which start as easily remembered numbers becoming amounts which subsequently appear more complex. This can be addressed through rounding which maintains the broad integrity of indexation while leading to simple values for dollar limits.

For example, if the 4.5% increase which was applied to index various 2005/2006 thresholds was applied to the $50,000 and $150,000 limits, they would be calculated as $52,250 and $156,750 respectively. These values could be rounded to $52,000 and $157,000. Alternatively, an even simpler approach would be to retain the undeducted contribution limit at exactly three times the limit for deductible contributions, that is, $156,000 in this case.

In applying rounding, calculation of the indexed limits should be based on the pre-rounding calculation of the index, in order to avoid "rounding on rounding".

Incidentally, if an indexation increase is expressed to the nearest 0.1%, as is usually the case (e.g. 3.7%), an indexation calculation on an amount of $50,000 is accurate only to the nearest $50.

We do not hold a strong view on how much rounding should be applied, other than to say that it should be one of $100, $500 and $1,000. We have a preference for $1,000 to support administrative simplicity.

Recommendation:

We recommend that the contribution limits be indexed annually using the change over the year to the March quarter in Average Weekly Ordinary Time Earnings. We also recommend that the resulting dollar amount for deductible contributions be rounded to the nearer $1,000 and the limit for undeducted contributions be three times the deductible limit.

Institute of Actuaries of Australia

28 July 2006

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

Dear John,

A Plan to Simplify and Streamline Superannuation –
Our Fourth Submission: Appropriateness of Contribution Limits

The attachment to this letter is the fourth submission in a series that the Institute is making in response to the invitation to comment on the Plan.

We support the removal of benefit limits and the move to focus simply on limiting contributions.

We believe that maximum annual deductible contributions of $50,000, if indexed, are likely to generate retirement benefits capable of funding an adequate retirement benefit for many Australians.

However, such contributions will be considered insufficient by many others, particularly those who are not able to save sufficiently in their younger years. Accordingly, we suggest that some flexibility be permitted to allow any shortfall from the maximum contribution in a year, to be made up in a later year. An approach to a "catch up" facility is put forward.

An approach to limit the utilisation of "recontribution strategies" by over 60's continuing to work is also suggested.

We accept the arguments for limiting annual undeducted contributions to $150,000. Again however, we suggest a "catch up" facility be made available to provide some flexibility in making such contributions. We believe this would be simpler to administer and more effective than the Treasurer's proposed "3 year averaging".

I would be happy to arrange for the members of our Task Force to discuss these recommendations further with you at your convenience.

Yours sincerely,

M A Stevenson
President

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The Treasurer's Superannuation Plan - IAA Submission

Topic 4 – Appropriateness of Contribution Limits

The Submission Topic

This submission focuses on the appropriateness of the contribution limits under the Treasurer's Plan, and suggests possible measures to introduce some flexibility in the administration of the limits.

Summary of Recommendations

Deductible Contributions

Need for "Catch Up" Facility

We believe that there will be many people who will consider that the $50,000 maximum annual limit for deductible contributions, even if indexed, will not allow them to accumulate adequate retirement benefits. Such people include particularly those who are unable to take full advantage of the $50,000 limit in their early years of working, even though able to in later years when they have achieved a lifestyle which they would reasonably wish to continue in retirement.

Accordingly, we suggest the introduction of a "catch up" facility. This would enable those individuals who can contribute more in later years to do so, where this is simply making up for contributions below the maximum made in earlier years.

Possible restrictions could be a maximum total contribution of $100,000 in any year, together with a maximum number of years for which "catch up" of contribution shortfall is permitted.

Recontribution Strategies

We note that individuals continuing to work after age 60 can withdraw tax free benefits to fund deductible contributions and obtain lower tax rates than would otherwise apply..

If the Government wishes to limit utilisation of the system in this way, one approach is to reduce the $50,000 annual contribution limit by the amount of any benefits taken in the year.

Undeducted Contributions

"Catch Up" Facility

We note that opportunities to make large undeducted contributions will be few for many people.

We suggest therefore that consideration be given to introducing a "catch up" facility along the lines suggested above for deductible contributions, albeit perhaps on a more restrictive basis.

<u>3 Year "Averaging"</u>

We believe that the Government's proposal in this regard would involve a significant level of administration, and would be better achieved on a retrospective or 'catch up' basis than on the prospective basis proposed.

Need for Concessional Tax Limits

We recognise the need for limits on contributions and/or benefits in order for the Government to limit the tax concessions available to superannuation arrangements, while at the same time encouraging individuals, directly and with the assistance of their employers, to provide adequately for retirement.

Type of Limits

We support the concept of just one form of limit, and also support that limit being focused on contributions.

We note that the government favours continuing with "deductible" and "undeducted" contributions.

Deductible Contributions - Adequacy of Limits

We also note that the "deductible" contributions limit of $50,000 per year, if indexed, is likely to allow most individuals who are able to save at this level (perhaps from around age 40) to accumulate amounts reasonably consistent with the "Pension RBL" under the current system (currently $1,356,291).

For someone able to contribute $50,000 every year from age 21 , the total accumulated amount at age 65, in today's dollars would be expected to be more than the current limit of $1,356,291 (at historical average investment returns), and hence purchase larger pensions.

However, only a tiny number of Australians will be able to contribute the full $50,000 each year from the commencement of their working lives. Indeed, many individuals are not able to save significant amounts until they have largely paid off their home mortgage and no longer have children to support, usually in their forties to fifties or even sixties.

Accordingly the $50,000 limit will not be meaningful to most people until their forties or fifties, and then may be seen as insufficient to allow them to build adequate retirement benefits.

Failure to make adequate contributions during some part of one's career arises in many different ways, for example –

- Females leaving the workforce or working only part time during child rearing years;

- Self-employed and employed people who have variable incomes (including people leaving the workforce, voluntarily or involuntarily, for varying periods);

- Those who can afford only limited contributions in their twenties and thirties and perhaps their forties.

We suggest that, on grounds of benefit adequacy (and, from a Government perspective, reduced ultimate reliance on the age pension), such individuals be permitted to make larger contributions when they are able.

Suggestion: To deal with these issues, it is suggested that the Treasurer's proposal for a $50,000 limit be extended to include a "catch up" facility This would enable those individuals who can contribute more in later years to do so, where this is simply making up for contributions below the maximum made in earlier years.

"Catch Up" Facility

The general principle of the 'catch up' facility we have in mind is that "unused" portions of prior years' contribution limits would be made available to allow individuals to 'catch up' after periods of low contributions.
For example:

Deductible Contributions

	Normal Maximum (1)	Catch up = Shortfall from Previous year (2)	Maximum for current year (3) =(1)+(2)	Contribution made (4)	Shortfall (5) =(3)-(4)
Year 1	$50,000	-	$50,000	$30,000	**$20,000**
Year 2	$50,000	**$20,000**	$70,000	$15,000	**$55,000**
Year 3	$50,000	**$55,000**	$105,000	$105,000	-

"Catch Up" Limits

Arguably, there need be no limits. The 'catch up' facility does not increase the individual's total entitlement to deductible contributions, it merely allows flexibility as to when the contributions are made.

If a 'catch up' facility is introduced, it could be applied over a whole working lifetime, or limited to a period such as 10 years or 7 years or 3 years. The Government may wish to limit either the maximum number of years' contributions that may be "caught up", or the maximum "catch up" contribution payable in any year, or both.

For example, the maximum contribution in any year (including the current year's maximum of $50,000) could be say, $100,000 and the maximum 'catch up' period limited to 7 years.

Transitional Arrangements

As already noted, the Government has historically recognised that some individuals may only be able to make significant superannuation contributions later in life by allowing larger deductible contributions for those over age 50.

We support the transitional arrangements permitting those aged 50 and over in the 5 years following the implementation of the Treasurer's Plan to make contributions up to $100,000 each year for a limited period.

We note that our suggested "catch up" facility providing for maximum contributions up to $100,000 in any year would fit well with these transitional arrangements.

Recontribution Strategies

We note that, under both the current system and the Treasurer's Plan, it is possible for a self employed individual to receive a superannuation benefit and then, if eligible, make a deductible contribution. Similarly an employee may receive a benefit, and then "salary sacrifice" to arrange for a contribution to be paid by his or her employer.

These procedures are supported as they are part of a system to encourage work flexibility and an increase in the rate of participation generally. However, low taxed or untaxed benefits may be deliberately withdrawn to fund tax advantaged contributions. In addition, the taking of the benefit in the form of a pension will mean that the supporting assets become exempt from tax.

Adoption of this "recontribution" strategy can generate a tax advantage. This may be the intended consequence of the government to encourage greater work-force participation amongst the over 60s. However if this is not the case the tax advantages could be seen as excessive.

Under the current system, total benefits ultimately received on the concessional tax basis are limited to the RBL or Pension RBL as applicable. Consequently, the tax advantages of a recontribution strategy under the current system receive some form of limitation.

However, under the Treasurer's Plan, there are no benefit limits, and benefits are not taxed if received after age 60. Accordingly, the ability and incentive to engage in a recontribution strategy after age 60 is increased. Indeed, the practice would become so standard that fund members would be considered as lacking financial awareness if they **didn't** carry it out every year to the extent that they were able.

In the light of this outcome, the Government may wish to place some restriction on the tax concessions available in respect of recontributions.

Suggestion: One approach is to reduce the amount of the maximum deductible contribution each year, ie, the $50,000, by any benefit that has been taken in the year.

In the case of employees for whom employers have made contributions, the amount taxed at 15% in the fund could be limited to the amount, if any, by which $50,000 exceeds the benefit withdrawn. Deductible contributions in excess of this would be taxed at 45%. (It is suggested that this process would be simpler to administer and fairer if the alternative system for taxing excessive contributions in the hands of the employee, recommended in our first submission, is adopted).

Undeducted Contributions

The purposes of allowing undeducted contributions under the current system are, as we understand them:

(1) to provide the opportunity for individuals to generate increased retirement benefits on a less tax advantageous (but still worthwhile) basis than for deductible contributions; and

(2) to enable low to middle income employees to make voluntary contributions which could be eligible for the Government's co-contribution.

We note that the co-contribution scheme will be extended to the self employed under the Treasurer's Plan.

In our second submission we argued that employees should be able to make deductible contributions directly (like self employed people) if they wished, rather than only through a "salary sacrifice" arrangement which requires the agreement and cooperation of their employer. We suggested that the co-contribution scheme could be easily amended to be based on deductible contributions, and we provided an example of how this may be done.

In practice however, the major proportion of undeducted contributions is made by wealthier people (either for themselves or through family members).

Undeducted Contributions - Limits

Under the current system, there are no limits to making undeducted contributions. This is presumed to be because any benefits arising (i.e. from tax favoured investment income on those contributions) would add to taxable benefits, and any excess over the RBL or Pension RBL as applicable would be taxed at a high rate.

The Treasurer's Plan will remove the taxation of all superannuation retirement benefits. Accordingly, it is reasonable for some limits to be imposed on future undeducted contributions so that the concessional tax treatment of investment income is focused mainly on assisting the provision of retirement benefits, rather than say, estate planning for wealthier individuals.

We note also that any excess benefits under the existing system are effectively taxed on a basis equivalent to the top marginal rate, broadly offsetting the superannuation tax concessions, whereas additional benefits generated from undeducted contributions under the new system are tax free

Consequently, we consider that the Treasurer's proposed annual limit of $150,000 is quite reasonable.

"Catch Up" Facility

Opportunities to make large undeducted contributions will be few for many people – perhaps release of equity in family home when trading down after children have left, inheritance, redundancy pay cheque, sale of a business.

Consequently, we suggest that the Government consider introducing a "catch up" facility for undeducted contributions along the lines suggested for deductible contributions in this submission.

Again, the Government may wish to limit the extent of any "catch up" facility – say to a maximum total contribution in any one year of $300,000 (which includes the current year maximum of $150,000).

A possible limit for the number of years for "catch up" may also be imposed – 3 years or $450,000. This could be administered by simply limiting the amount of the shortfall to be carried forward in any year to $450,000.

3 Year Averaging

We are unsure of the merits of the "3 year averaging" facility proposed by the Treasurer. This will involve significant additional administration for superannuation funds and monitoring by the ATO, but for negligible extra tax. Administration is also increased where refunds must be arranged when a member makes a contribution in advance that subsequently he or she may not be eligible to make.

Since tax relief on the contributions is not an issue, any excess amount available over the $150,000 limit could readily be held in a bank account for contribution in following years.

While the "3 year averaging" approach has effectively already commenced, we believe that it could be blended into a 'catch up" facility at a later date.

Expressed another way, a 'catch up' facility can be described as 'retrospective averaging', whereas the proposal in the Treasurer's Plan for three-year averaging of undeducted contributions is 'prospective averaging'. We consider that 'prospective averaging' has administrative difficulties, but that some form of 'retrospective averaging' (i.e. in our terminology 'catch up'), is more practical.

Savings Enhanced

Our "catch up" facility suggestions would, if implemented, result in increasing savings through superannuation and we would not expect them to lead to any diminution in national savings.

28 July 2006

Mr J Lonsdale
Superannuation Retirement and Savings Division
The Treasury
Langton Crescent
PARKES ACT 2600

Dear John

A Plan to Simplify and Streamline Superannuation -
Our fifth submission: Death and Disablement Benefits

The attachment to this letter is the fifth of a number of submissions that the Institute will be writing in response to the invitation to comment on the Plan.

This submission has six components –

5A. Taxation and preservation requirements for Lump Sum Total and Permanent Disablement Benefits

5B. Taxation of Lump Sum Death Benefits

5C. Anti Detriment Provisions for Death Benefits

5D. Salary Continuance or Total but Temporary Disability Income Benefits

5E. Distribution of Lump Sum Death Benefits

5F. Adequacy of Lump Sum Death and Total and Permanent Disablement Benefits

Whilst we acknowledge that no changes are proposed to these aspects in the Treasurer's Plan, the Plan will change the environment in which they operate, leading to anomalies. We believe these "knock-on" effects should be dealt with, and this submission makes a series of recommendations accordingly.

We note that in addressing the issues under 5E on the distribution of death benefits, we are conscious that while affecting a minority of people, death benefit distribution is a major issue for those involved; it is usually sensitive and sometimes traumatic. Furthermore, the outcome can be affected by a wide range of circumstances and issues that make establishing simple rules difficult. In this context, our Task Force that prepared this submission have offered some conclusions based on their consideration of the issues.

However, before pursuing any change we advocate undertaking broader community consultation. We would be please to provide further input to such consultation.

Our proposals are summarised on the first page of the attached submission. They focus on ways in which the system can be amended to achieve, in relation to death and disablement benefits:

- Simplified administration;
- Fairer outcomes for members; and
- Improved access to insurance coverage.

We urge the Treasury to consider carefully these proposals and, as far as possible, either to implement them concurrently with the other parts of the Treasurer's Plan or, if that is not practicable, to put them on the agenda for the next phase of superannuation reforms.

I would be happy to arrange for a member of our Task Force to discuss this submission with you at your convenience.

Yours sincerely

M A Stevenson
President

The Treasurer's Superannuation Plan – IA Aust Submission

Topic 5 – Taxation, Distribution, Preservation and Adequacy of Death and Disablement Benefits

This submission comprises six sections. Each is listed below and together with a summary of our proposals put forward in this submission. The details of our proposals are explained and argued in the remainder of the submission.

5A. **Taxation and preservation requirements for Lump Sum Total and Permanent Disablement Benefits**

Total and Permanent Disablement Benefits be made on a tax free basis at all ages.

If the Total and Permanent Disablement Benefit is made on a tax free basis, we would also advocate that the ATO adopt a more rigorous process to assess total and permanent disability.

5B. **Taxation of Lump Sum Death Benefits**

Align the definitions of Dependant in SIS and the Tax Act. In particular, allow adult children to be considered as dependants.

If no changes are made then grandfathering of some existing pension arrangements with attached reversionary pensions will be necessary.

In cases where a member dies after age 60, either:

(i) Remove the tax differentiation between dependants and non-dependants by making these death benefits tax free.

or

(ii) Tax only the insured component of a death benefit paid to a non-dependant when death occurs after age 60.

If (i) above is adopted, make all death benefits tax free, in order to achieve administrative simplification from the removal of tax differentiation between dependants and non-dependants at all ages.

Reversionary pensions payable to dependants should also be tax free.

5C. **Anti Detriment Provisions for Death Benefits**

Remove anti-detriment provisions.

5D. **Salary Continuance or Total but Temporary Disability Income Benefits**

We believe clarification of the position is required regarding whether the benefit is a pension or ordinary income, and taxed accordingly.

If it is a pension, its taxation basis will also need to be specified.
If the view is taken that the benefit is a pension, then under the Treasurer's Plan there would now be no measurement against RBL. We would expect that the income benefit could be paid tax free to any member over 60 with some tax paid at younger ages. If this is the case then the treatment may be more generous than current practice.

5E. Distribution of Lump Sum Death Benefits

We recommend that industry consultation be undertaken to find the most efficient process for the distribution of superannuation death benefits, and to recommend any required amendments to current legislation to accommodate changes.

5F. Adequacy of Lump Sum Death and Total and Permanent Disablement Benefits

FBT relief is currently given to employers on insurance premiums for employee temporary disability income benefits. We recommend that this relief be extended to cover premiums for lump sum death and total & permanent disablement.

This approach would 'free up' Member Choice for investments while assisting employers to make coherent arrangements for death and disability benefits for their employees.

5A. Taxation and preservation requirements for Lump Sum Total and Permanent Disablement Benefits

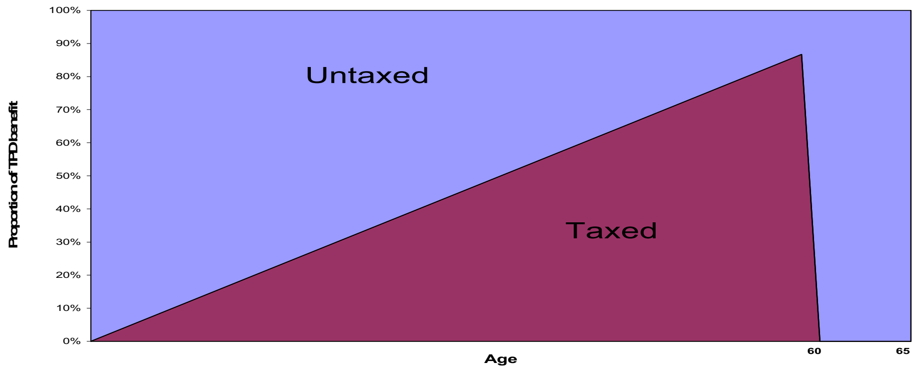
Background

The Treasurer's Plan proposes continuation of the tax free post June 1994 invalidity component but no further detail is specified. We make the following observations.

The dovetailing of the invalidity component gives less tax advantage to older members who leave due to total and permanent disablement.

The invalidity component was designed to give advantage to those who left early due to total and permanent disablement. Its operation allows the part of the member's benefit notionally attributable to future service to be tax free whilst the benefit notionally attributable to past service is taxable. The effect of the invalidity component is therefore to give a tax free benefit to a person disabled at the start of his or her career, dovetailing into the fully taxed benefit at retirement that applied under the old system.

Under the new system benefits are tax free at the start of a member's career and tax free at the end (from age 60). Hence tax on the invalidity component in the interim years increases progressively to age 60, then falls abruptly to zero, as shown in the following illustration.



As can be seem from this illustration, the operation of the invalidity component will therefore disadvantage older disabled workers who under the new tax system may be very close to the point where they could receive tax free benefits.

Conclusion: The tax on invalidity benefits has become anomalous under the Treasurer's Plan and should be removed.

Those taking total and permanent disablement benefits pay more tax than those retiring at age 60. However the disabled may have greater need than other retirees due to increased living costs and a longer retirement phase.

Analysis of total and permanent disablement statistics from an insurer indicates that two-thirds of those claiming total and permanent disablement benefits do not have a substantially reduced life expectancy. This means that:

- they still require their superannuation benefits to fund what might be a long retirement period;
- they may incur additional living expenses as a consequence of their disablement; and/or
- they may have dependants for whom they are responsible and have no possibility for future employment.

It appears inequitable for this benefit not to be treated on the same basis that would have applied had the member been able to work gainfully up to age 60 and then take a similar benefit on a tax free basis.

Conclusion: The case for correcting the anomaly described above is, in our opinion, a very strong one.

The tax rules treat differently members and their dependants who are in very similar circumstances.

Death benefits paid to dependants are tax free whilst total and permanent disablement benefits are taxable. In addition, 'anti detriment' payments (see section 5C) are not available on disablement.

Analysis of total and permanent disablement statistics from an insurer suggests that around a third of claims made are from causes that might be expected to result in significant lowering of life expectancy, such as cancer, heart disease and so on. Because these members can be expected to die in the short term, it is reasonable that they be treated in a similar way to those who claim death benefits. However, these members are required to pay tax on their benefits whilst death benefits are tax free.

A disabled person may require funds to set family financial affairs in order before he or she dies. However, if the member dies shortly after the benefit has been paid, the family has suffered additional tax which would not have been payable had the benefit payment been deferred and paid instead as a death benefit.

This is particularly relevant given the recent trend of insurers paying out benefits on the diagnosis of terminal illness. These benefits allow early payout of death benefits as total and permanent disablement benefits on terminal illness. This will result in higher numbers of disablement payments in lieu of death benefits.

Conclusion: The anomaly of taxing invalidity benefits is emphasised when considered against the tax arrangements for death benefits.

The ATO process to establish total and permanent disablement is less rigorous than the processes that Trustees adopt under SIS to pay insured benefits.

> Under the current ATO process, fund members provide sign off from two doctors to the Trustee in order for them to be considered permanently disabled for tax purposes. This allows their benefit to be released before age 55 under SIS and allows a tax benefit from the invalidity component. For a total and permanent disablement benefit to be paid the member must also comply with the fund's definition of Total and Permanent Disablement. For this Trustees generally adopt a more rigorous process typically involving reports from doctors, specialists, and occupational experts. As we are recommending a tax free benefit on Total and Permanent Disablement it is reasonable for the ATO to seek a higher level of proof that the fund member is in fact totally and permanently disabled.

Conclusion: There is a case for the ATO to introduce a more rigorous process for establishing total and permanent disability.

Total and permanent disablement benefits normally represents quite a small proportion of total benefits paid from a superannuation fund.

Conclusion: removing tax on total and permanent disablement benefits should have a negligible effect on revenue.

Recommendations

1. **Permanent disablement benefits be made on a tax free basis at all ages.**

2. **The ATO to adopt a more rigorous process to assess permanent disablement.**

These measures would provide equity between those who need to take a permanent disablement benefit, those who die leaving dependants and those who retire after age 60. It is more generous than at present but, in the context of the Treasurer's Plan where retirement benefits may be taken tax free to age 60, it is more logical and equitable than the status quo (which is proposed to continue and which favours younger members over older members).

5B. Taxation of Lump Sum Death Benefits and Reversionary Pensions

Background

There are differences in the definitions of Dependant under SIS and under the Tax Act.

The main points of difference are that adult children are considered as Dependants under SIS but are not considered as Dependants under the Tax Act. Conversely, an ex-spouse is not automatically considered a Dependant under SIS whereas an ex-spouse is considered a Dependant under the Tax Act.

A further difference exists in relation to anti-detriment provisions as the definition of Dependant for the operation of anti-detriment does not include Interdependency relationships (whereas the tax definition does include interdependency in relation to death benefit taxes).

This means that an interdependent may receive a tax free death benefit but is not eligible for an anti-detriment payment.

Conversely, an adult child, who must generally pay tax on the death benefit, is eligible to receive an anti-detriment payment. Please note it could be argued that anti-detriment should not have applied in cases where tax was not previously paid on death benefits.

Currently on the death a member a reversionary pension can be paid to a dependant in which the SIS Act definition of dependant applies.

The new proposals indicate that the Tax Act definition of dependant will apply in future and that a pension would not be able to revert to a non-dependant on death.

This will be inconsistent with some arrangements already in place and in the absence of any other changes we suggest grandfathering the existing pension contracts.

Conclusion: Differences in the definitions of dependant are problematical and should be rationalised.

Large tax differentials based on unclear definitions lead to avoidance strategies and additional work for Trustees who need to adjudicate on the conditions.

Where there are large differentials in taxation based on unclear definitions, there may be tax planning strategies to avoid payment. This position favours those who can afford advice.

Where there is a tax differential for a benefit, Trustees need to assess the circumstances. If rules are clear this is relatively straightforward. In some instances, however, Trustees need to adjudicate on some difficult circumstances as to whether or not a person is to be considered a Dependant under the ATO definitions. This takes a disproportionate amount of Trustee time and cost.

For those with no dependants (including adult children), death benefits are taxed but retirement benefits from age 60 are tax-free.

Under the Treasurer's Plan, at age 60 a member may fully withdraw a benefit and pay no tax. However, if the member dies after age 60, either before having taken a benefit because the member chose to remain in the workforce, or after having chosen to take a pension in preference to a lump sum, tax will be payable on the remaining benefit if paid to a non-dependant (including adult children).

After age 60 any insured component of a death benefit is likely to be very small. The death benefit paid is therefore in most cases the same amount as the member's retirement benefit which could be taken tax free.

Consider the case of a couple who choose to keep their savings within the superannuation environment, for example as an allocated pension. On the death of the first partner there can be a seamless transition with the pension transferring to the surviving spouse. However, on the death of the surviving spouse now, if the benefit is then paid to an adult child, there will be tax payable. On the other hand, if the surviving spouse had cashed out the superannuation just before death then the benefit could have transferred to the adult child tax free via the estate.

Conclusion: Consistency would require taxes on death benefits payable to non-dependants to be eliminated if death occurs after age 60. If any tax is to be payable it should be limited to the insured component for those over 60.

Discontinuity in tax rules can influence behaviour when applied to elective benefits but exerts no influence in the case of death benefits.

Under the Treasurer's Plan tax is payable on benefits paid to those who choose to take their benefits at ages between 55 and 60 and this should encourage members to continue in the workplace at least to age 60. In the case of death benefits, there being no choice involved, any tax incentive or discouragement is of course ineffective and so there would appear no reason for the tax payment to discriminate on the basis of age. In particular it could produce inequity for those close to 60.

Conclusion: Consistency would require taxes on death benefits payable to non-dependants to be eliminated if death occurs before age 60.

Inconsistency in the tax treatment of reversionary pensions

The proposals suggest that from 1 July 2007 the Tax Act definition of dependant, as opposed to the SIS Act definition, will apply for reversionary pensions. This means that in future all reversionary pensioners will be dependants as assessed against the Tax Act.

The proposals suggest that when a pensioner dies, the tax treatment of the reversionary (ongoing) pension will depend on the age of both the original pensioner and the reversionary pensioner. In brief, when the original pensioner dies:

- the pension will automatically continue to be tax free regardless of the age of the reversionary pensioner if the original pensioner was already over 60; but
- if the original pensioner was not over 60 at death, the pension will only be tax free once the *reversionary* pensioner is over 60.

As in future all reversionary pensioners will be dependants under the Tax Act, we suggest that the reversionary pension should be taxed as if it was a death benefit.

Conclusion: The reversionary pension payable to dependants should therefore be tax free irrespective of the age of the original pensioner or the reversionary pensioner.

Recommendations

1. Align the definitions of Dependant in SIS and the Tax Act. In particular, allow adult children to be considered as dependants.

2. If no changes under (1) are made then grandfathering of existing pension arrangements with attaching reversionary pensions will be necessary.

3. In cases where a member dies after age 60, either:

a) Remove the tax differentiation between dependants and non-dependants by making these death benefits tax free.

or

b) Tax only the insured component of a death benefit paid to a non-dependant when death occurs after age 60.

This approach would be justifiable on grounds of equity, recognising that the taxation of death benefits will not cause a modification in behaviour (whereas encouraging a deferred retirement age for retirement benefits can cause behaviour change).

4. If 3(a) is adopted extend the removal of the tax differentiation between dependants and non-dependants to all ages by making all death benefits tax free.

This approach would also have the very real and important advantage of reducing the disproportionate amount of Trustee time taken to establish dependency for tax purposes. It would incidentally resolve any current concerns of uneven treatment for same sex relationships.

5. Make reversionary pensions payable to dependants tax free.

5C. Anti-Detriment Provisions for Death Benefits

Background

These provisions were introduced in 1988 with introduction of the contributions tax. Previously, retirement benefits were taxed but death benefits were tax free.

When contributions tax was introduced 'anti-detriment' arrangements were put in place covering death benefits to ensure that members were not disadvantaged by the "bringing forward" of tax from benefits to the contribution payment stage. The provisions aim to return the contributions tax paid to those who claim a death benefit. This was deemed necessary as death benefits were not previously taxed. The new contributions tax arrangement would have otherwise resulted in an additional tax on death benefits.

These anti-detriment provisions are complex to apply and yet yield only small benefits to recipients. They are often unclaimed as they are largely unknown to members. In the context of the Treasurer's Plan the provisions may even be viewed as inequitable as they are not available to those claiming total and permanent disablement benefits. These members and their dependants may be in very similar circumstances to the dependants of members who die but under the current tax arrangements are not only required to pay benefits tax, but also are unable to claim anti detriment payments. The effect of these transitional provisions is increasing and there is no sunset clause.

- **Complex to administer –** Under the Treasurer's Plan, the anti-detriment provisions remain. The individual calculations required can be complicated and each individual payment must be accounted for by the Trustee in order to reclaim tax. This adds complexity for the administrator of a fund and the gain for members is offset by the cost to the Trustee of recalculating the benefit and reclaiming tax.

  Where benefits are paid via an estate, it is possible that the administrator is not aware that the anti-detriment benefit can be claimed. If a claim is made then the costs and complication involved are significant.

- **Members generally unaware of the provisions –** Members are generally unaware of the existence of the anti-detriment provisions.

  In view of the complexity involved, it is possible, particularly where benefits are paid to the member's estate, that many providers do not pay or reclaim anti detriment payments. This is indicated by the fact that one provider has recently introduced anti detriment payments as a new feature of their arrangements and is using this fact as a marketing tool.

- **No "sunset 'arrangements –** The effects of transitional arrangements are generally designed to reduce over time. In contrast, the impact of anti-detriment is increasing as time progresses and there are no "sunset" arrangements to stop this.

  As noted above, these provisions were introduced in 1988 with introduction of the contributions tax. Many new members have joined the superannuation system since then. It could be argued that those who join the superannuation system after 1988 should always have been excluded from the provisions – this essentially means those currently aged under around 40. This avenue could be pursued if Treasury wished to curtail this provision.

- **Anti detriment could be viewed as inequitable –** Very few people would now be aware of the anti detriment provision and its history. In the context of the Treasurer's Plan the provisions may even be viewed as inequitable as they are not available to those claiming total and permanent disablement benefits. These members and their dependants may be in very similar circumstances to the dependants of members who die but under the current tax arrangements are not only required to pay benefits tax, but also are unable to claim anti detriment payments.

- **Differences in definitions for Dependant that apply for anti-detriment and under SIS result in anomalies -** Interdependency relationships are not included for the purpose of anti-detriment by the ATO (whereas the tax definition does include interdependency in relation to death benefit taxes).

  This means that a dependant may receive a tax free death benefit but is not eligible for an anti-detriment payment.

  Conversely, an adult child, who must generally pay tax on the death benefit, is eligible to receive an anti-detriment payment. Please note it could be argued that anti-detriment should not have applied in cases where tax was previously paid on death benefits.

Conclusion: Removal of anti-detriment provisions is well justified in the context of the proposed major changes and the simplifications that will result.

Recommendation

- **Remove anti-detriment provisions**

We believe that this measure is well justified in the context of the proposed current wide ranging changes..

5D. Salary Continuance or Total but Temporary Disability Income Benefits

Background

There is currently some confusion relating to the taxation of these income benefits within superannuation funds. Some tax advice suggests that the income benefit is a pension and under the current system should be taxed as a pension with a 15% tax rebate with the benefit payments counting towards the member's RBL.

In practice, to our knowledge, this is not the approach taken by superannuation funds. Currently these payments are taxed as member's income and are not counted towards the member's RBL.

Clarification Requested

We believe clarification of the position is required regarding whether the benefit is a pension or ordinary income, and taxed accordingly.

If it is a pension, its taxation basis will also need to be specified.

If the view is taken that the benefit is a pension, then under the Treasurer's Plan there would now be no measurement against RBL. We would expect that the income benefit could be paid tax free to any member over 60 with some tax paid at younger ages. If this is the case then the treatment may be more generous than current practice.

5E. Distribution of Lump Sum Death Benefits

Background

In the current environment, most members cannot be absolutely sure in advance as to how their death benefits will be distributed.

Trustees distribute death benefits in line with their Trust Deeds, which commonly require the Trustee to distribute to a member's dependants and, if there are no dependants, then to the member's estate.

There are essentially three methods adopted in distributing benefits: non-binding nominations, binding nominations and payments direct to the estate. We consider each in turn:

- ***Non Binding Nominations – not secure and payments can take a long time to resolve.***

  Members may make non-binding nominations setting out their preferred beneficiaries but the Trustee must distribute in line with the Trust Deed. Whilst the member's nomination may be taken into account, the Trustee is not bound by the nomination.

  An example where a death benefit was not distributed in line with a member's nomination to his spouse was recently outlined in an article in ***Risk in Practice***. The member had nominated his wife as sole beneficiary but the Trustee ultimately resolved to divide the benefit between the widow and adult children from a previous marriage. The process took almost a year to resolve and in this case there was no SCT involvement.

  The Trustee process outlined in the article was in line with the process adopted by many if not all Trustees. This is not therefore an isolated case and there was no inference that the Trustee should have been able to resolve the issue sooner.

  By way of illustration, a typical process on receiving notice of the death of a member would be:

  (i) Write to the next of kin and employer requesting a listing and contact details of all those who could be considered dependants under the definitions of the Trust Deed.
  (ii) Request from the relevant contacts documents as appropriate, including a certified copy of the will, birth certificates, death certificates, marriage certificates, divorce documentation and where necessary documentation showing full or partial financial dependence, and where necessary declarations and/or documentation relating to interdependency.
  (iii) Send all dependants Statutory Declarations for completion, setting out the benefit that is to be distributed and whether or not the dependant wishes to be considered for receipt of a payment.

(iv) Having collected all relevant information on potential dependants, the Trustee considers the information including the non-binding nomination and makes its decision regarding the distribution.
(v) The Trustee may then make a determination, giving all potential dependants 28 days in which to dispute the determination.
(vi) If all dependants are in agreement then the payment is made.
(vii) If dependant(s) disagree then the Trustee has 90 days to respond to complaints and there may be iterations of dispute.
(viii) If a resolution is not possible then the claim will be heard by the SCT.

Because the Trustee must seek to establish all the dependants a member may have, and because it may take some time to receive responses under (i), (ii) and (iii) above, the process can be quite lengthy. It would be considered a good result if a distribution is made in 3 months. A longer period of around 6 months is more common. A more extended timeframe results if there is dispute.

Whilst members within families commonly have wills in place, young unmarried members typically have not made wills.

The research required to establish dependence can appear invasive and insensitive. In addition, contact is made with a number of dependants and information revealed, such as the amount of the benefit, that some may prefer to keep private.

- ***Binding Nominations – not always secure and a lengthy time is often needed for the Trustee to establish the position***.

  Some funds allow Binding Nominations but these may not ultimately be valid as they must be witnessed and updated every three years to be valid. Binding as well as non-binding nominations may be invalid if the member nominates a person who cannot be considered a dependant under SIS. The status of a person's dependency may change over time and if the Binding Nomination has not been revoked the Trustee may be bound to make a payment to an inappropriate beneficiary. Binding nominations can therefore be even more problematic as members may incorrectly believe that their nominations are secure.

- ***Payment direct to the estate – need to wait for probate.***

  Where Trust Deeds are set up to pay benefits direct to the estate, payments can be decided and made quickly by the Trustee. However, there can be delays before probate is obtained and there are some costs for the dependants in applying for probate. This would not be required if superannuation was the only member asset and it was paid direct to a beneficiary.

  One point to note in relation to the payment of any benefit direct to an estate is that if the member had creditors then the payment would become available to pay creditors before both dependants and non-dependants.

If all benefits were required to be paid to the member's estate then the member could consider superannuation assets along with all other assets. In addition a superannuation fund would not be required to consider issues of dependency. This would be resolved by the executor of the estate who would ultimately distribute the benefit.

If the member died without making a will then the benefit proceeds would be distributed in line with the relevant state law.

Conclusion: On balance the Task Force believe that direct distribution via a member's estate gives the greatest level of certainty to the member.

Trustees may be unable to change their Trust Deeds to pay benefits direct to the member's estate, without direction.

It is possible to set up funds so that all death benefits are payable to a member's estate. However, if a current Trust Deed requires a Trustee to exercise a discretion to pay to dependants then, for legal reasons, some consider it unsafe to amend the Trust Deed to allow payment only to a member's estate. Trustees are not therefore in a position to resolve this issue without a requirement for them to pay death benefits to a member's estate.

Conclusion: Most trustees would need to amend their Trust Deed to effect a change in the way they distribute death benefits. In many instances this could only be legally achievable if it became a regulatory requirement to pay death benefit proceeds in a particular way, for example direct to a member's estate.

Is the time and expense spent by Trustee's and the SCT on death benefit distributions adding value for members?

A great deal of trustee time can be spent on deciding to whom a member's death benefit should be paid and, if to more than one person, then in what proportions.

A major part of the work of the Superannuation Complaints Tribunal (SCT) work relates to distribution of death benefits.

Trustees can be involved in costly and protracted disputes in relation to the distribution of death benefits. These family disputes need not be played out in a superannuation forum (where other members share the administration expense). They are likely to be duplicated in other legal forums along with other actions in relation to the member's estate.

We believe many members do not fully appreciate the processes that must be followed by Trustees to distribute death benefits and would be surprised to find that benefits are not in practice automatically paid to their nominated beneficiary. Further we believe that many members do not appreciate the time that it may take to finally resolve the distribution of a benefit.

In view of the processes that must be followed members are unable to rely upon their nomination of how they wish their death benefits to be distributed. This limits their ability to make fully secure financial arrangements for all their dependants.

If benefits were distributed to a member's estate then much of the Trustee process would disappear. Members could organise all their affairs via their estate that they control.

There are also impacts which some would consider negative such as:

- If a member is bankrupt then the benefit would be available for creditors whereas payment direct to a dependant may protect them.
- There may be greater ability to structure payments in a tax effective way when paid direct to dependants at the direction of a Trustee. This may be particularly relevant for small funds.
- There may be longer delays in payment to the final beneficiary via the estate in the more straightforward cases. Again this is likely to be of greater concern for small funds.
- Superannuation proceeds would become subject to the intestacy provisions under state law, which may not operate in as favourable a manner as a trust arrangement, from the beneficiaries' point of view.

Conclusion: The Task Force believe that the additional Trustee processes in distributing death benefits direct to dependants do not generally add value. In some respects they detract value for members as they are unsure of outcomes and this impedes their ability to plan their financial affairs. We believe the advantages that can be gained from requiring benefits to be paid to a member's estate are substantial and therefore worthwhile.

However there are some negative aspects to this approach that will need to be worked through, in particular an expected longer settlement period for the most straightforward cases. There is therefore a need for further debate and industry consultation to find the most efficient process for the distribution of superannuation death benefits.

Recommendations

We believe that if all death benefits were paid via the member's estate (and if the member died intestate, then distributed in line with the relevant State law) there would be several valuable benefits:–

- If this measure was taken members would be able to make secure financial arrangements for all their dependants. They would be able to direct how their benefits were to be distributed within their estate. It would allow all assets to be considered together in the estate rather than as separate pieces.

- This measure would have a large impact in terms of reducing complexity, delays and costs for Trustee's resulting from disputed death benefit distributions. Any dispute is likely to be duplicated in relation to other member assets in the estate and so should serve to reduce overall legal costs.

- Given the current processes required to ensure death benefits are distributed in members' best interests (some of which require resolution by the SCT) this change would not result in greatly extended delays in beneficiaries receiving benefits.

- Trustees would no longer need to assess dependency or decide to whom benefits should be paid. We believe that a great deal of time is spent by both Trustees and the SCT on distribution of benefits but we do not believe there is commensurate adding of value for members, and in some instances it could be considered unhelpful.

However there are also impacts which some may consider negative. For instance, if a member dies and is bankrupt, this approach would result in assets being made available for creditors before both dependants and non-dependants. Also the settlement process may be longer for the most straightforward cases, and the provisions of state intestacy law may not act as well in the interests of the beneficiaries as they or the member may have wished.

On balance, we believe that such effects are likely to be outweighed by the advantages described above in many cases. However to achieve change and to create a new climate there would need to be industry consultation in order to –

- establish a wider common understanding of the issues,

- ascertain a more effective process for the distribution of superannuation death benefits, and

- determine any required amendments to current legislation to accommodate changes.

5F. Adequacy of Lump Sum Death and Total and Permanent Disablement Benefits

Background

Members may choose from superannuation funds that offer varying levels of insurance cover.

Some employers have expressed concern that they no longer have the ability within superannuation to ensure that their employees are consistently and adequately covered in the event of death and disablement.

Under the new Choice and Portability conditions employees can choose funds that offer widely differing insurance options. As a result employers cannot be assured that all their staff are consistently or adequately covered by insurance.

Conclusion: Under Choice and Portability employers can no longer ensure all employees are adequately covered by insurance.

Over time some funds may be required to introduce individual underwriting for insurance that could deter members and hence further reduce insurance coverage.

Over time, it is likely that the proportion of members who are members of a particular Company fund will fall. Insurers generally require that 75% to 85% of eligible employees join a given fund in order to provide a material level of automatic cover – i.e. provide an automatic acceptance limit (AAL). An unintended consequence of Choice is therefore that some superannuation funds may not meet the insurer's conditions to retain their right to operate an AAL. The AAL system allows all new members, irrespective of insurability issues that may otherwise apply to them individually, to take insurance cover up to the AAL without the need for medical underwriting.

Conclusion: If AALs are lost then members will require individual underwriting for their insurance and as a result some members will not be able to obtain cover and furthermore, over time, it can be expected that take-up of cover will fall.

Employers are not in a position to offer new employees a promised level of insurance cover.

There is anecdotal evidence that not being able to reproduce current insurance cover without underwriting can affect an individual's decision about taking new employment.

Conclusion: Lack of certainty surrounding insurance cover may impede workforce mobility.

Investment returns are a member's main focus in assessing the performance of their superannuation arrangements.

Members tend to choose and leave a superannuation fund based on the fund's investment performance. Insurance is a secondary issue and can muddy the water of decision making.

Conclusion: Choices would be clearer for some members if their superannuation and adequacy of insurance cover could be separately considered.

It is more expensive from a tax perspective for an employer to provide employees insurance cover outside superannuation.

FBT is payable on premiums for insurance of death and total and permanent disablement benefits designated for payment to the employees. In contrast no FBT is levied on premiums covering temporary disability income benefits for employees. Therefore, if as an alternative employers wish to set up additional insurance arrangements for their employees outside of superannuation, it is not tax effective for them.

The lifting of FBT on death and total and permanent disablement premiums could encourage more employers to consider insurance programmes for their employees outside superannuation. The employer would pay benefits direct to the member on disablement and as per the recommendation under 5E above on death. Benefits should be payable on a tax free basis. These policies could cover all staff and as a result insurers could continue providing AAL conditions and continuation options.

Employers would be in a position, if they wished, to be certain that their staff were consistently and adequately insured.

Conclusion: Lifting FBT from premiums would provide a level playing field from a tax perspective so employers could choose to provide insurance cover for their employees inside or outside superannuation in a cost effective manner. This could help increase the overall level of insurance in the community, including access to insurance by those otherwise not able to obtain cover.

Recommendations

1. FBT relief is currently given to employers on insurance premiums for employee temporary disability income benefits. We recommend that this relief be extended to cover premiums for lump sum death and total and permanent disablement.

This approach would provide a level playing field so that employers, if they wish, could provide lump sum death and total and permanent disablement insurance arrangements for their employees as a Company benefit outside of superannuation in a cost effective manner.

We believe that the issues surrounding insurance resulting from the Treasurer's Plan together with recent Choice and Portability legislation will emerge slowly. Whilst they may not currently be deemed to be urgent the issues are very important and should be resolved as part of the implementation of the Treasurer's Plan.

Institute of Actuaries of Australia

28 July 2006

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

Dear John,

A Plan to Simplify and Streamline Superannuation –
Our Seventh Submission: Voluntary Deductible Contributions for Employees

The attachment to this letter is the seventh submission in a series that the Institute is making in response to the invitation to comment on the Plan.

This submission advocates that the government take the opportunity to widen the ability for employees to make voluntary deductible contributions beyond "salary sacrifice" agreements with their employers.

This proposal stands independently of the proposal in our first submission regarding administration of contribution limits. It is noteworthy, however, that this proposal on voluntary deductible contributions would be very straightforward to implement if our proposal on administration of contribution limits is adopted.

Furthermore, adoption of this proposal on voluntary deductible contributions would add materially to simplicity, eliminating for most fund members the distinction between deductible and undeducted contributions.

As well as simplicity, the proposal would improve equity across the employee population, since not all employees have access through their employers to salary sacrifice arrangements. There may also be an increase in aggregate superannuation contributions, which should add to national savings.

I would be happy to arrange for the members of our Task Force to discuss these suggestions further with you at your convenience.

Yours sincerely,

M A Stevenson
President

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The Treasurer's Superannuation Plan - IAA Submission

Topic 7- Voluntary Deductible Contributions for Employees

The Submission Topic

This component of the Institute's submission advocates that the government take the opportunity to widen the ability for **employees to make voluntary deductible contributions** beyond "salary sacrifice" arrangements with their employers.

The Position under the Treasurer's Plan

At the present time, and under the Plan, employees are not able to make voluntary deductible contributions (except in rare situations where they receive no employer support).

Employees who are able to arrange a "salary sacrifice" agreement with their employer can obtain the equivalent benefit to that which would be obtained from making personal voluntary deductible contributions directly, i.e. they gain tax relief on their voluntary contributions. Also, under the Treasurer's Plan, self-employed people will now be able to make voluntary deductible contributions up to the annual limit.

Salary sacrifice arrangements require the co-operation of the employer, who is not obliged to assist. Arguably, this discriminates against those employees earning more than the proposed $25,000 threshold for the 30% marginal tax rate who are unable to make such arrangements with their employers. It is notable that many part-time and lower income employees will be in this position, and women are likely to be over-represented in this group.

Alternative Approach

It is proposed that the opportunity for all employees to make deductible contributions directly to funds be introduced. Employees would be able to make regular contributions from their weekly, fortnightly or monthly pay, or make separate contributions, provided their total contributions including SGC contributions did not exceed the annual limit (proposed to be $50,000).

If this proposal is adopted, the cumbersome salary sacrifice system would no longer be required and the associated discrimination would disappear. All employees would be able to make greater voluntary contributions through a more flexible direct process. They could also do so without paying income tax in advance if they were able to make declarations in similar fashion to the declarations available for dependants.

It is also submitted that if the alternative approach to the administration of the $50,000 limit, as advocated in our first submission, were adopted, the introduction of voluntary deductible contributions for employees would be a very straightforward matter.

Voluntary Deductible Contributions – Government Co-contributions?

If the government decides to permit voluntary deductible employee contributions, it is likely that many employees would choose to make such contributions rather than undeducted contributions, except to the extent necessary to qualify for any government co-contribution.

There are now two choices:

- retain the co-contribution scheme as it is, available only for undeducted contributions, or

- extend it to cater for voluntary deductible contributions.

If the co-contribution scheme were to be extended to deductible contributions, some adjustment to its terms would need to be made. A possible revised structure for the co-contribution scheme applied to deductible contributions, providing similar benefits to those current, is attached as an Appendix.

Simpler for Self-Employed

This approach would also have the benefit of enabling self-employed members to avoid the need to compare making deductible contributions against making undeducted contributions and qualifying for a possible co-contribution under the government's proposed arrangements – refer last paragraph of section 5.2.2 of the Detailed Outline.

Many self-employed people have fluctuating incomes and are uncertain during each year as to the final level of their income for the year. Hence they will be uncertain about the extent to which they will qualify for a co-contribution and the amount of undeducted contributions required.

Voluntary Deductible Contributions – Undeducted Contributions?

If employees were permitted to make voluntary deductible contributions and the government's co-contribution system were amended to focus on deductible contributions, then the need for undeducted contributions would be limited, in many cases, to those individuals who wish to contribute more than the $50,000 limit for deductible contributions.

The significantly fewer numbers of members paying undeducted contributions would make monitoring the limits for these contributions easier.

Advantages

This proposal stands independently of the proposal in our first submission regarding administration of contribution limits. It is noteworthy, however, that this proposal on voluntary deductible contributions would be very straightforward to implement if our proposal on administration of contribution limits is adopted.

Adoption of this proposal on voluntary deductible contributions would add materially to both *simplicity* and *equity* –

> Regarding simplicity, it would eliminate, for most fund members, the distinction between deductible and undeducted contributions.
>
> Regarding equity, the proposal would improve equity across the employee population because not all employees have access through their employers to salary sacrifice arrangements (and those who do not are predominantly lower income and part-time employees).

There may also be an increase in aggregate superannuation contributions which, while increasing aggregate concessions, should add to national savings. This effect is likely to be limited, however, because it is usually the lower income earners, on marginal tax rates of 30% or less, who do not have access to salary sacrifice arrangements. One would expect the aggregate extra concessions net of the 15% contributions tax to be much smaller than the tax concessions already associated with salary sacrifice arrangements.

APPENDIX

Superannuation Tax Reform

Government Co-contribution Scheme –
Conversion from Undeducted Contributions to Deductible Contributions

A benefit currently available is the "government co-contribution" for low to middle income employees. This has been used extensively and has been successful in encouraging voluntary contributions.

Both the employee's contributions and the government's co-contributions are undeducted contributions under the current system.

Alternative System based on Deductible Contributions

(i) Employees (as well as the self employed) would receive tax deductions in respect of their voluntary contributions, and contributions tax would be paid by the superannuation fund; and

(ii) contributions tax would also be paid on the co-contributions.

The co-contribution structure would be changed to recognise the impact of the taxes and tax deductions on the contributions. For example:

Current System	**Proposed System**
* the Government matches each $1 of a member's personal contributions each year with a co-contribution of $1.50, up to a maximum of **$1,500**; * the maximum co-contribution amount is payable if the member's total taxable income is less than **$28,000**; * the maximum co-contribution is phased out at 5 cents for every dollar above **$28,000**, eventually cutting out at **$58,000.**	* the Government matches each $1 of a member's personal contributions each year with a co-contribution of $1.50, up to a maximum of **$1,800**; * the maximum co-contribution amount is payable if the member's total taxable income is less than **$24,000**; * the maximum co-contribution is phased out at 5 cents for every dollar above **$24,000**, eventually cutting out at **$60,000.**

Maximum Voluntary Contribution *(to receive maximum co-contribution)*

Under the current system the member's maximum contribution to receive the benefit of the maximum co-contribution is **$1,000**.

It is suggested that the equivalent maximum level of employee contribution under the proposed system is **$1,200**. Contributions tax paid by the superannuation fund would be 15% of $1,200, i.e. $180. Thus the net amount effectively invested by the member is $1,200 – $180, i.e. $**1,020**.

Government Maximum Cost per Member

Under the current system the government's maximum cost per member is **$1,500**.

Under the proposed system the government's maximum cost of the co-contribution is:

Government co-contribution	$1,800
less contributions tax (15%)	($270)
Total maximum cost	**$1,530**

Comparison between Current and Proposed Systems

A comparison of the maximum costs of the co-contribution at various income levels is as follows:

Annual Income	Government Current System	Cost Proposed System
$	$	$
24,000	1,500	1,530
28,000	1,500	1,360
38,000	1,000	935
48,000	500	510
58,000	Nil	85
60,000	Nil	Nil

This is, of course, only one example of a co-contribution structure under the proposed system; alternative co-contribution structures could be developed.

The above analysis and co-contribution cost amounts do not allow for the net costs to government revenue of the tax deductibility of the individual's contributions under our proposal. Such costs would be in addition to the above."

Institute of Actuaries of Australia

28 July 2006

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

Dear John

A Plan to Simplify and Streamline Superannuation
Windfall Transitional Gains

We understand that the main aims of the proposals in the Treasurer's Plan have been to produce simplification and increased participation in the work force. We note that there have been some trade-offs in equity in order to achieve major steps forward in simplification.

The major measure is to remove taxes on benefits. Many members currently retiring have benefits below the tax free threshold. Consequently, it is only those with larger benefits who gain from the Treasurer's initiatives.

Those who gain most are members with "excessive" benefits under the current system. Such benefits are taxed at 38%, rather than the basic 15% so that the removal of benefit taxes provides a significant "windfall" gain.

While generally accepting the equity trade offs to achieve simplification, we are aware of some community concerns regarding the generosity of removing taxes from those with excessive benefits, many of whom have benefited from higher transitional RBLs and the grandfathering of pre 1983 benefits on a minimal tax basis.

If measures are to be taken in relation to excessive benefits they will need to be in place at the transition date. They will need to be simple to explain and simple to implement.

If Treasury is considering any action in relation to excessive benefits or other types of windfall gain, the Institute would be very happy to assist in providing advice with respect to a practical approach to this issue.

I would be happy to arrange for the members of our Superannuation Tax Reform Task Force to discuss this subject with you at your convenience.

Yours sincerely

M A Stevenson
President

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