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18 May 2006

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

Dear Sir

Re: Request for public submissions pertaining to the proposed new superannuation arrangements

My submission is limited to the matter of transfers of (real) commercial property into a Self Managed Superannuation Fund (SMSF)

The new superannuation provisions have been introduced to simplify and streamline superannuation. I am writing with regard to an area where the budget announcements result in serious disadvantage.

The existing superannuation provisions enable (real) commercial property (ie the property itself rather than the value derived from the sale of the property) to be transferred into a self managed superannuation fund (SMSF). For reasons outlined below, the proposed cap on the amount of undeducted contributions has effectively removed the ability to make such property transfers.

Even if (three year) averaging provisions are introduced, it would appear to be no longer possible to transfer a commercial property to a SMSF, given that such property is generally valued at over \$450,000.

It was suggested to me by your office, that the excess amount of undeducted contributions could be withdrawn from a SMSF in such instances. However, this would not be possible where:

- The contributor has not reached the minimum age of retirement; or
- There are no liquid funds available to be withdrawn.

I was in the process of transferring a commercial property (valued at \$900,000) into a SMSF when the superannuation changes were announced. The proposed undeducted contribution limit, effective from the date of the budget, has severely disadvantaged me, and would appear to preclude the intended transfer taking place (it should be noted that there was no prior indication that such wide ranging changes to superannuation were being planned).

- I am seeking a review of the limit on undeducted contributions, as it applies to the transfer of real commercial property, to allow continuation of existing arrangements which provide for the transfer of such property to a SMSF.

In the case of tenanted commercial property, the effect of such a change on consolidated revenue would not be significant as, under the currently proposed arrangements, the income tax liability from rental on such property held outside superannuation can, in effect, be offset by the taxpayer making a tax deductible contribution to superannuation equal to the income tax payable on the rental income (each year up to age 75).

Alternatively, to ensure no disadvantage as a result of the budget announcements, transitional arrangements could be introduced (at least for those aged 50 and above) which would either:

- Enable transfer of (real) commercial property to a SMSF (as under existing arrangements) up to 1 July 2007; or
- Provide an exemption to the cap on undeducted contributions for the capital gains tax exempt value of (real) commercial property transferred to a SMSF, similar to the exemption provided for proceeds from the sale of a small business; or
- Extend (for a transitional period) the proposed averaging provisions to enable transfers of (real) commercial property to a SMSF.

This would ensure that such commercial property transfers to a SMSF, either in progress or planned, can proceed without being disadvantaged by the budget announcement.

I hope that there will be a favourable outcome with regard to this matter.

W 82

14 June 2006

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

Dear Sir/Madam

Submission/Comment on a *Plan to Simplify and Streamline Superannuation*

The Government should allow for a once only transitional post-tax contribution period to be averaged over six-years or longer for people aged 60 at budget night to accommodate larger one-off payments.

In my own case, I will be 64 on the 9th of February 2007 and I am unable to contribute an amount I recently inherited. This amount is substantially in excess of the proposed \$150,000 annual cap or proposed \$450,000 cap over three years. I was waiting to put these funds into a superannuation fund that was starting an allocated pension from July 06 - MTTA Superannuation fund.

I am now retired and currently living on the interest of my inheritance. I am not claiming any Government assistance and I pay private health insurance. After working all my life since the age of 14, having never claimed unemployment benefits, I am at the end of my working life only to find that I am locked out of access to superannuation. I have no way of making tax deductible contributions as I do not own a business or investment property.

As part of the proposed changes, the Government may consider a three-year period to accommodate larger one-off payments, however this is not nearly long enough. A six-year or longer period is necessary to cater for those people nearing retirement who were planning to make large lump sum contributions under the previous scheme.

The above submission may be published, however I do not wish my name and address to be published.

**A Case for Further
Simplification of the
Current Budget
Proposals in Connection
with the Public Service
Superannuation Funds.**

July 28, 2006

A case for further simplification of the Public Service Superannuation Funds

*What has been proposed improves things
for many, but not for all.*

I welcome many of the initiatives of the Budget proposals in the area of Simplification of the Superannuation System. However I have some reservations about the proposed treatment of the Public Service Superannuation funds. These funds, for some reason, which I cannot understand, are to retain the complex, costly to administer provisions of taxation and offset rebates, which they currently have. My comments below relate to one such superannuation scheme namely the Commonwealth Superannuation Scheme (CSS), a fund to which many public servants have and still do contribute to. A similar situation will apply to other public sector funds.

I submit that a modification to the current budget proposals would be most appreciated by many Public Servants nearing retirement and those who have retired and have elected to receive a pension from this fund.

The Commonwealth Superannuation Scheme (CSS)

The Commonwealth Superannuation Scheme (CSS), a fund of which I am a member, is a fund, which provides retirement benefits from both taxed and untaxed sources. It is administered by Comsuper. I am told by CSS that the payments to retirees are from two sources, which had different tax treatments in the hands of the fund. The consequences of this are that they are subject to different tax treatments in the hands of the beneficiaries of the fund when they leave the accumulation phase of saving for retirement

On reaching the preservation age and opting to retire I was given a choice of taking a pension or a lump sum from the untaxed funds and a pension or lump sum from the taxed funds in CSS. I expect this practice to continue after July 1, 2007. To me it appeared as if I was being given two pensions options from two different funds. I was amazed. All discussions I have ever had used the term the "CSS Fund" not the "CSS funds".

I was told one "pension" was paid from money in the fund and the other one was from money contributed by my employer at the time of each one of my pension payments. Independent decisions needed to be made with respect to both choices. To add to the confusion only one such "pension" is indexed.

I am told by staff at CSS that there is only one CSS fund, however, most of my pension, derives from the untaxed employer contributions, whilst the rest of my pension is from taxed sources. In the main the CSS Fund¹ does not receive the employer contribution on a "real time" basis during the accumulation phase.

- *I ask, "Is this something that I control"?*
- *The answer is a clear "NO"*
- *"Should this be something that I, as a retiree, should bear the tax burden for?"*
- *Again my answer is, "NO."*

Payments to Retirees from the Untaxed Employer Contribution

From the information, which I received from CSS, it appears that the employer, the Commonwealth of Australia, has decided to structure the superannuation fund on the basis of not contributing to the fund during the accumulation phase. They pay their contribution at the time that preservation conditions are reached. I am told that this employer contribution is paid directly to the retiree. The retiree is then taxed at their marginal tax rate. The Budget Proposals do allow for increased rebates. However increasing a rebate is not simplifying the tax treatment of "end-benefits" in my view. By not contributing on a real time basis to the fund when making fortnightly salary payments to their staff, the employer, the Commonwealth of Australia, retains the use of the funds till the retirement of the employee.

If the employer contribution were made on a real time basis then the fund would have this money available for investment. It is true that tax at 15% would be paid on the employer contribution and on the earnings the fund derived from this contribution. However, there would still be both 85 % of the contribution and 85% of the earnings in the fund. I would say that the fund would be better off today if the employer contributions had been paid on a real

¹ The only exception is the 3% productivity component paid by the employer on a real time basis and taxed at 15%.

time basis. Even if that money was invested in conservative investments such as mortgages and fixed interest deposits I would say that these contributions would have grown in the period of time for which the employee was a contributor. With inflation I would argue that 85% of the employer contribution 20 years ago would be at least equal to 100% today.

One also needs to recall that the 15% contributions tax was introduced in the days of the Keating Government whilst many public servants have/had 30 to 40 years of eligible service. Prior² to the introduction of the 15% contributions tax, all of the funds would have had untaxed employer contributions

Payments from retirees from the Taxed Pool of Funds

In addition to the future employer contributions, the CSS Fund has on its balance sheet:

- *The post 1990, 3% employer contributions, which were taxed.*
- *The compulsory employee contribution; post tax at the employee's marginal tax rate.*
- *The earnings of the fund, which are taxed in the fund at 15%.*

It is clear to me that by keeping two sources of money within the one fund, two artificial funds are created. One of these funds (the untaxed "fund") is merely a contingent asset until the preservation conditions are met.

For the sake of this discussion if we consider that the employer was a hypothetical employer in the private sector; Ordinary Joe, who ran an office he would have had to pay the Superannuation Guarantee (SG) of 9% at the time of employment, not a Productivity Component of 3%, which is what the Commonwealth of Australia paid to CSS. This extra amount would have been taxed and would have earned money, which would also have been taxed.

On retirement Ordinary Joe's employees would receive a tax-free pension post July 1, 2007, if they were aged over sixty. This is not what is proposed for the CSS retiree. I submit that the CSS fund is no different from Ordinary Joe's fund. After all it did pay contributions tax on all money it held in the fund.

² Few superannuation funds would have existed before the 1990s.

Real Time Employer Contributions

It is certainly true that some of the benefits for the CSS retiree are paid from untaxed money from their ex-employer, the Commonwealth of Australia. Does that matter?

The employer in this case has had the use of its money until the retirement of the employee. The employer has elected not to contribute to the fund. By this action it meant that it chose to retain the money and also not to tax itself the 15% tax on contributions, during the period that Ordinary Joe's contributions were taxed. The employer has also taken a chance that some employees may leave the fund before retirement and so no contribution will be required on an actuarial basis.

On the other hand, the CSS members, paid tax on their compulsory contributions on a real time basis, at their marginal tax rate. The employer only contributed a 3% productivity component in real time. This amount is less than the superannuation guarantee levy Ordinary Joe paid. The productivity levy was taxed at 15%.

On the facts supplied to me, I suggest that there is only one pool of funds in CSS. I suggest that this pool is taxed. The employer contribution, which pays for the main part of the retirement benefits of the fund's members, is a contingent asset of the fund. Contingent assets are not subject to a contributions tax until such time as they are contributed.

Suggested Modifications

I wish to suggest two possible modifications, which would simplify the taxation of "end-benefits" for CSS members. This I believe will be more equitable and would bring the treatment of "end-benefits" for CSS members in line with those currently proposed for members of taxed funds.

One solution would be to pay this untaxed money from the Department of Finance to the CSS Fund as a contribution after the member becomes entitled to a pension or lump sum benefit. Furthermore, I suggest that because many retirees have been members from a time before the 15% contribution tax was introduced it would not be fair to tax all of the previously untaxed funds from which their pension is derived at the 15% tax rate.

I suggest that the CSS fund determines the taxable and non-taxable amounts of the pension. One way to do this is to calculate a "taxable ratio" and apply it to the pension derived from the untaxed funds. Tax should be paid only in proportion of the post tax years to total years of membership of the fund.

The fund pays the 15% tax on contributions according to a calculated taxable ratio. This ratio would be obtained by dividing taxable years by total years of membership in the CSS Fund for each member (the taxable ratio). This is because the quantum of the amount received from as the Department of Finance will depend on years of membership and other criteria such average final salary for each member. After the appropriate amount of tax is deducted by the fund the pension is passed on to the retiree.

If this solution were applied, then all of the funds, which are distributed to the retiree, would be from taxed funds. The tax would be paid by the fund out of its pool of funds. The pension then would be tax free in the hands of the retiree. (Refer to suggestion 2 in example below.)

OR

If the CSS Fund does not wish to involve itself in the payment of the pension from the untaxed funds then the recipient would need to do the calculation to obtain the taxable ratio and pay the 15% tax accordingly. (Refer to suggestion 1 in example below.)

I favour the treatment referred to as Suggestion 2 in the example below because it is a true simplification of an “end-benefit” in line with the Budget recommendations for taxed funds.

Example³

Public Servant contributes to fund for 35 years. Plans to retire .on July 1, 2007 aged sixty.

On retiring on July 1, 2007 aged 60 years receives pension from CSS of;

- \$40,000 p.a. from previously untaxed funds
- and \$5,000 p.a. from taxed employer contributions and undeducted contributions.

Suggestion 1

Lets assume that tax on contributions has been law for 20 years.

(The taxation of contributions did not exist for the whole period that the public servant was in the fund.)

³ The numbers used in the example have been selected in order to demonstrate concepts being discussed. They do not relate to any factual situation.

- 1 Calculate the taxable ratio

$$\begin{aligned} \text{Ratio of years pre contributions tax to total years} &= 20/35 \\ &= 0.571 \end{aligned}$$

On retiring on July 1, 2007 aged 60 years receives pension from CSS of \$40,000 p.a.
from previously untaxed funds.

$$\text{The taxable ratio} = 0.571$$

- 2 Calculate the portion of the pension from untaxed funds, which is taxable at 15%.
$$\begin{aligned} \text{Taxable pension} &= 0.571 \times \$40,000 \\ &= \$22,857.14 \\ \text{Taxable pension component} &= \$22,857.14 \end{aligned}$$

I suggest that only \$22,857.14 is taxed at the 15% rate in the hands of the retiree.

$$\begin{aligned} \text{Tax deducted} &= 0.15 \times \$22,857.14 \\ &= \$3,428.57 \end{aligned}$$

The rest of the pension from untaxed funds (\$17,142.86) is tax-free even though
it originates from untaxed funds.

- 3 The \$5,000 pension from taxed funds and post tax contributions should also
be tax-free.

Suggestion 2

- 1 The Department of Finance pays CSS the money for the retiree's pension from
untaxed funds when it is due and payable.
- 2 The CSS Fund deducts and remits 15% tax on this money according to the taxable
ratio. This would mean that tax of 15% would be deducted from \$22,857.14 by the
fund (\$3,428.57). An amount of \$17,142.86 will continue to be untaxed.

It treats the employer contribution it exactly as any fund would.

- 3 The CSS Fund pays both the \$36,571.43 and the \$5,000 from the other previously taxed source to the retiree. A total of \$ 41,571.43 is received by the retiree. All of the money is tax free in the hands of the retiree in exactly the same way as all "end- benefit" payments from the so-called "taxed" superannuation funds.

Suggestion 2 is simpler for the retiree. I believe that this suggestion is more in line with the Policy intent to simplify "end-benefits" from Superannuation Funds.

Are The Proposals Fair And Equitable To Public Service Funds?

The CSS members have had as part of their working conditions the promise of a defined benefit pension. The employer has provided as a condition of employment a defined benefit superannuation fund. It is a provision of the CSS Trust Deed, that there is a defined benefit when the preservation conditions are met.

It is true that the life span of retirees is longer than it used to be. It is true that a defined benefit pension recipient on average is likely to live longer in current times than in the past. I suggest that such a "total cost of benefits" argument is not connected with the taxation status of the pools of funds from which the pension is paid.

A defined benefit pension is part of the entitlement of being a member of the CSS fund. The fact that employer is funding the benefit on an actuarial, rather than a value of corpus of the trust and/or earnings of the trust basis, should not relate to its taxation status in the hands of the beneficiary.

The fact that the employer, the Commonwealth of Australia, did not tax itself with respect to the notional pool of funds it provides for the payment of the “end-benefits” of its employees should not cause the said employees to bear a tax burden in connection with the “end-benefits” of their superannuation.

My understanding was that the May 2006, Budget Proposals were about simplification of superannuation end-benefits and not about the cost of the CSS superannuation fund. I fail to see any simplification relating to the Public Service Funds in these proposals. I also am amused by the term “untaxed” being applied to such funds. The only part that is untaxed is the main employer contribution. The reason that it is untaxed is because it is not contributed to the fund. It is merely a contingent asset till the employee retires.

In this brief paper I have dealt with the matters that relate to contributions during the accumulation phase of planning for retirement. I have outlined the very direct and simple equity argument in terms of a comparison of the taxed and untaxed funds. In the examples above I have suggested two possible solutions for the treatment of “end-benefits” of the CSS Fund to bring it in line with other funds, which are the subject of the Budget Superannuation Simplification Proposals.

I have not touched on the more complex provisions, which the Commonwealth Government has for transition to retirement benefits. If properly structured such benefits are worth thousands of dollars on retirement to the average contributor to a superannuation fund. The Public Service fund does not allow such benefits to be maximized. Such a restriction does not support the policy intent of the Government to encourage older workers to stay in the workforce longer.

I have been told that many State public servants are moving out of Public Service superannuation funds to those run commercially so that they can benefit from the salary sacrifice and transition to retirement provisions to the fullest extent. Being in a Public Service fund prevents such benefits being maximized.

It appears to be a “double whammy” to have public servants not able to maximise the transitional benefits and to have them subjected to tax on their retirement funds whilst those in funds run by the private sector reap the benefits from both measures.

Is it that the government does not feel that the vote of the public servant is worth considering?
I would be surprised if that was so. Perhaps the apparent inequalities are merely an oversight
and will be reviewed and corrected in the enacted Budget?