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9 August 2006

General Manager
Superannuation, Retirement & Savings Division
The Treasury
Langton Crescent
Parkes, ACT 2600

Dear Sir,

Submission in respect of A Plan to Simplify and Streamline Superannuation

I am pleased to enclose our Submission in response to the Government's *Plan to Simplify and Streamline Superannuation*.

Our Submission addresses only one matter, relating to the taxation of superannuation entitlements received before the age of 60, as permitted under the SIS Regulations.

As explained in our Submission, we have identified a serious inequity faced by the terminally and seriously ill, in relation to the taxation of their entitlements. This inequity is not addressed in the Government's *Plan to Simplify and Streamline Superannuation*, and is, in fact, made worse by the proposed laws.

Unless the proposal contained in our Submission is adopted, the terminally and seriously ill may be the only members of the community paying tax on superannuation entitlements.

These issues have come to our attention through our work with the Peter MacCallum Cancer Institute, as described in our Submission, and we urge the Government to remedy this injustice.

We are available to discuss any aspect of our Submission with you.

Thank you for this opportunity.

Yours sincerely,

Kenneth Gray
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SUBMISSION TO TREASURY

THE TAXATION OF EARLY ACCESS SUPERANNUATION

Executive Summary

Existing and proposed laws relating to the taxation of superannuation benefits:

- treat unfairly the terminally ill and others with life threatening illness;
- increase their financial stress; and
- hamper their ability to put their affairs in order before death.

These inequities arise because superannuation benefits received by a dependent after death are tax free but the same benefits received before death (in very limited circumstances permitted by law) are partly taxed (if received on the basis of total and permanent disability) or wholly taxed (if received on the grounds of financial hardship or other compassionate grounds).

There is, therefore, an "advantage" in leaving funds in superannuation until after death, but this "advantage" deprives the patient of funds to meet living expenses and treatment costs (at a time when he or she is unable to work because of illness and likely to be facing financial stress) and of the opportunity to repay debts and put his or her financial affairs in order while still capable of doing so.

The proposed reforms to superannuation make the inequity worse – people over 60 will pay no tax on receipt of superannuation benefits and no reasonable benefits limits will apply, yet younger patients in dire need will be the only people in the community still paying tax on superannuation benefits. Although these patients are not 60, in some cases they are, unfortunately, living the only "retirement" they will ever have, and ought to be entitled to the same treatment as other retirees.

These inequities can be cured at no cost to Commonwealth Government revenue, because no tax is collected if funds are left in superannuation until after death. Allowing the funds to be accessed early does not result in tax foregone.

Existing law only permits early access to superannuation in very limited circumstances, overseen by the Australian Prudential Regulatory Authority (***APRA***), so there is no risk of abuse of the opportunity to access funds early free of tax.

In our submission, sections 27AAA(3) and (4) of the *Income Tax Assessment Act* 1936 (the ***Tax Act***) should be amended to apply, not only to the receipt of superannuation by a dependant after the death of the member of a superannuation fund, but also whenever superannuation is accessed before the age of 65 in any of the circumstances described in Items 103, 105, 107 and 109 of Schedule 1 of the *Superannuation Industry (Supervision) Regulations* 1994 (the ***SIS Regulations***).

SUBMISSION TO TREASURY

THE TAXATION OF EARLY ACCESS SUPERANNUATION

Introduction

1. This Submission has been prepared in response to the Commonwealth Government's invitation for comments on its "Plan to Simplify and Streamline Superannuation" as announced in the Commonwealth Budge in May 2006 (the Government's proposals are referred to in this Submission as ***the proposed changes***).

2. This Submission is made by the law firm of Baker & McKenzie, based upon experience acting *pro bono* for the patients of the Peter MacCallum Cancer Institute, as described in paragraphs 7 to 10 below.

3. Baker & McKenzie welcomes this opportunity to draw to the attention of Treasury the inequitable taxation treatment of the superannuation entitlements of the terminally and seriously ill. This inequity exists under current law but will be exacerbated by the proposed changes.

4. For reasons that we will set out below, persons who access superannuation before the age of 60 on grounds of temporary or permanent incapacity, severe financial hardship or other compassionate grounds are likely to pay tax on some or all of their superannuation entitlements when:

   (a) if those same entitlements were left in their superannuation fund and paid to dependants after death, no tax would be payable; and

   (b) from July 1, 2007 persons aged over 60 will not pay tax on superannuation benefits.

5. When superannuation is accessed on the grounds of incapacity, a partial exemption from tax may be available by reason of the concept of the "post June 30 invalidity component" found in section 27G of the Tax Act, but no exemption is available when superannuation is accessed during life on grounds of severe financial hardship or other compassionate grounds.

6. In our submission:

   (a) the taxation "advantage" to be derived by leaving funds in superannuation until after death:

      (i) deprives the patient of sorely needed funds at a time of financial, emotional and medical crisis;

      (ii) deprives the patient of the opportunity to settle debts and order his or her affairs prior to death, leaving this task to a grieving family;

      (iii) increases the stress of the patient, potentially interfering with his or her medical treatment and possible recovery;

   (b) to continue to tax patients under 60 when older members of the community are not taxed is unjust and inconsistent with what appears to be the Government policy to financially assist retirees, particularly when it is noted:

      (i) many of these patients will not, sadly, reach the age of 60 and are living the only (enforced) retirement they will have – they ought to have access to their retirement savings on the same basis as any other members of the community;

      (ii) access to superannuation before the age of 60 is closely controlled by the Government via APRA and there can be no legitimate concern that the general policy of providing superannuation benefits late in life will somehow be

eroded (many of the patients are, of course, late in their life, they just happen to be young);

(c) there is no reason to treat those persons who access superannuation for financial or other compassionate reasons differently (because no exemption is available) from those who access superannuation on the grounds of incapacity (for whom a partial exemption may be available). It is indeed ironic that those who access superannuation funds on grounds of financial hardship will be the main group to have some part of their badly needed funds taken by Government;

(d) changing the law to exempt superannuation payments from tax when they are accessed early:

(i) will not involve any material cost to the revenue:

(A) as the tax can currently be avoided simply by leaving moneys in the superannuation funds to be accessed after death by dependants;

(B) very few people meet the conditions for early release of superannuation; and

(ii) is, in any event, consistent with the tax liberalisation reflected in the proposed changes.

Baker & McKenzie & the Peter MacCallum Cancer Institute

7. Baker & McKenzie has become aware of the issues the subject of this Submission as a result of work undertaken jointly with the Peter MacCallum Cancer Institute (www.petermac.org), the foremost cancer centre in Australia, with which Treasury is no doubt familiar.

8. Since October 2005, Baker & McKenzie, in conjunction with the Social Work Department at Peter Mac, has provided a "patient assistance service", under which we provide free legal advice to cancer patients unable to otherwise obtain legal assistance. To date, most of the work of the Patient Assistance Service has involved assisting patients with access to their insurance and superannuation entitlements. We have assisted 25 patients in relation to their superannuation entitlements since the service commenced in October 2005.

9. Attached as Annexure A is an article from the Victorian Law Institute Journal providing more detail in relation to the Baker & McKenzie/Peter Mac Patients Assistance Service.

10. Our Patient Assistance Service has provided us with a regular, systematic and on-going exposure to the needs and circumstances of people with life threatening illnesses. This Submission is based on our "live" experience, and not on once-off, or occasional, involvement with a handful of patients. Our work with the Patient Assistance Service has lead us to appreciate that the problems and injustices identified in this Submission are not isolated, or personal to some individuals, but entrenched and systemic.

The Needs of Our Clients

11. Our clients are coping with life threatening illnesses and in many instances are terminally ill and their treatment is palliative. As you would appreciate, they are in personal, social and economic crisis. They are from all ages, backgrounds, nationalities and walks of life, as cancer does not discriminate. Many have young families.

12. As our Patient Assistance Service helps patients who cannot otherwise obtain legal assistance, our clients are at the most disadvantaged end of the financial spectrum. They are typically people with little or no savings (beyond superannuation) or other assets (many of them do not even own a home). They are all unemployed, by reason of their illness, and have no means of

support other than social security or the support of their families. They are typically people with other debts (such as for credit cards, car loans and utilities) which were manageable while they were well, but which have become impossible due to ill health. In some cases, cars have been repossessed, just at the time they are most needed for transport to medical facilities, and home owners are usually under pressure from mortgagees as a result of the financial circumstances caused by their illness.

13. Access to superannuation represents the best chance our clients have of bringing some semblance of financial order to their lives, to pay for medical costs and transportation, to meet at least some of their debts and alleviate pressure from creditors, and to meet ordinary living costs for themselves and their families when they have no other income. Early access to superannuation also provides an opportunity to order affairs and pay off debts before death, instead of leaving this task to a grieving family. Often the family may not know much about the financial affairs of the deceased, particularly when the deceased was the key breadwinner and managed the family's finances.

14. The backgrounds and financial circumstances of our clients mean that they do not have large amounts of superannuation. Our clients have never been high income earners, and their superannuation reflects only the minimum statutory entitlements, based upon their (usually low) wages while working. In our experience, we are dealing with superannuation entitlements of only a few thousand dollars to a maximum of $50,000 or so.

Early Access to Superannuation

15. As you would be aware, accessing superannuation before the age of 60 is not easy.

16. By regulation 6.18 of the *SIS Regulations*, the amount that can be cashed out of a superannuation fund by a member is restricted. If a member meets the "condition of release" specified in Column 2 of Part 1 of Schedule 1 to the *SIS Regulations*, the amount that can be cashed is calculated in the manner specified in Column 3.

17. Relevantly for the purposes of this Submission, Schedule 1 to the *SIS Regulations* permits the cashing of benefits as follows (subject always to the terms of the fund, in the case of (a), (b) and (d)):

    (a) Item 103 - in the event of "permanent incapacity", in which event there are no restrictions as to the amount that can be cashed;

    (b) Item 105 - in the event of "severe financial hardship", in which event between $1,000 and $10,000 can be cashed if the person has been on Commonwealth income support payments for 26 weeks (and if not, nothing can be cashed);

    (c) Item 107 - on "compassionate grounds", in an amount determined by APRA (and regulation 6.19A of the *SIS Regulations* details the purposes for which funds may be accessed);

    (d) Item 109 - in the event of "temporary incapacity", in which the amount to be cashed is restricted to a non-commutable income stream to preserve (as far as possible) income before incapacity, and only for so long as incapacity continues.

18. As you would also know, following the death of the member of a fund, the entitlements may be paid to a person previously nominated by the member in a notice given to the trustee of the fund, subject to the terms of the fund: regulation 6.17A of the *SIS Regulations*. There are no

restrictions placed on the amount or use of funds accessed by a nominated person after the member's death[1].

19. The point we wish to emphasis in this Submission is that early access to superannuation is closely regulated and restricted by a government agency. If, as we are submitting, taxation of benefits when accessed early should be liberalised, there is no risk of "floodgates" opening or of an unmanageable burden being placed upon the revenue, and the Commonwealth, via APRA, remains in control of early access.

Differential Tax Treatment

20. The taxation of superannuation benefits is unquestionably complex and we welcome the simplification proposed by the Commonwealth Government.

21. For the purpose of this Submission, we wish to highlight only one aspect of the current and proposed laws to demonstrate the tax disadvantage, and inequity, suffered by those who are entitled to access superannuation early (in the very limited circumstances noted above).

22. The point of this Submission is apparent from the simple comparison of:

    (a) the taxation of a superannuation benefit received by a member of a superannuation fund prior to the age of 60 on the basis of either:

        (i) incapacity; or

        (ii) financial hardship or other compassionate grounds; and

    (b) the taxation of a dependant receiving a superannuation payment following the death of a member, either directly pursuant to a notice to the trustee of the fund as described above or as beneficiary of an estate.

23. In the first case (paragraph 22(a)), the payment is potentially taxable as an eligible termination payment (falling within paragraphs (b) or (ba) of the definition of eligible termination payment in section 27A of the Tax Act. Some components may be tax free or concessionally taxed, but there is no concession simply because the superannuation is accessed early on the grounds permitted under the *SIS Regulations* and, unless some other concession applies, the superannuation payment is taxable.

24. If a superannuation fund member is permanently incapacitated, section 27G of the Tax Act may apply, with the result that a component of the eligible termination payment (determined in accordance with the formula in section 27G) will be tax free.

25. If, however, superannuation is accessed on any other ground, the entire eligible termination payment will be taxable[2].

26. In stark contrast, a payment received by a dependant after a members death attracts the concessions contained in sections 27AAA(3) and (4) of the Tax Act. If the superannuation entitlement is paid directly to the dependant by the trustee of the superannuation fund, the payment is wholly exempt from tax up to the reasonable benefits limit: section 27AAA(3)[3]. If the superannuation entitlement is distributed by the trustee of the deceased's member's estate, the Commissioner of Taxation has a discretion to exempt the payment from tax to the extent the Commissioner considers that a dependant will benefit from the estate.

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[1] It is, in our view, inappropriate that a terminally ill fund member should be denied unfettered use of his or her own retirement funds when his or her nominee will have unfettered use of a financial "windfall" following death of the member. That point is, however, beyond the scope of this Submission.

[2] leaving aside, for the sake of simplicity, concessions available on other grounds to both the fit and well and the incapacitated without discrimination (eg any pre1983 components, CGT rollovers etc)

[3] with the reasonable benefits limitation to be abolished as part of the proposed changes

27. This means that terminally ill patients and their families are clearly better off by leaving funds in superannuation until after death. This is a terrible choice with which to confront the dying and their grieving families. It is unfair and unjust to make them choose between:

    (a) leaving money in superannuation to avoid tax and thereby:

        (i) lose access to money for living expenses;

        (ii) lose access to money for the care of the patient or for medicines, transportation etc;

        (iii) continue to struggle under existing debts and pressure from creditors; and

        (iv) lose the opportunity to order affairs while the patient is alive to contribute to the process; and

    (b) paying a material portion of their sorely needed retirement funds to the Government so that they can live, pay doctors, but medicine, pay debts and order their affairs.

28. The funds belong, after all, to the patient. The patient will not have a normal "retirement" and will not otherwise have the opportunity to benefit from the savings accumulated during his or her working life.

29. If less tax is paid when the dependant receives the superannuation after death, they receive a "windfall" in terms of the tax saving, a windfall denied to the patient.

30. <u>In our Submission there is no reason or interest requiring additional tax to be paid simply because superannuation is accessed by a patient before his or her death as compared to by his or her family after death</u>.

31. When the proposed changes remove tax on superannuation benefits at age 60, it becomes even more obvious that the terminally ill should not be left as the only members of the community paying tax on superannuation benefits.

Changes Proposed

32. The simple change that will overcome injustice and enhance fairness is to amend section 27AAA so that the exemption contained in sections 27AAA(3) will apply to all superannuation payments received in the circumstances specified in Items 103, 105, 107 and 109 of Schedule 1 to the *SIS Regulations* (and to the corresponding items in Part 2 of that Schedule applicable to approved deposit funds).