



PITCHER PARTNERS

ACCOUNTANTS AUDITORS & ADVISORS

Level 19
15 William Street
Melbourne
Victoria 3000

Tel: 03 8610 5000
Fax: 03 8610 5999
www.pitcher.com.au
partners@pitcher.com.au

Postal Address:
GPO Box 5193
Melbourne Vic 3001
Australia

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VAM:dmf

9 August 2006

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

Dear Sir

A PLAN TO SIMPLIFY AND STREAMLINE SUPERANNUATION

The Detailed Outline to this Plan issued in May 2006 provided the opportunity to provide our comments on the content of the Plan. We submit our comments in the attached document.

In making this submission, we recognise the Government's right and responsibility to set the policy parameters in respect of the superannuation system in Australia and to determine where and to what extent income tax concessions are made available.

We will not, therefore, argue whether the announced policy measures should or should not be implemented by Government. Rather, we raise concerns we have about the implementation of these various measures. We also provide suggestions as to how the matter of concern may be dealt with.

If you have any questions, please contact David Foulds on 8610 5353 or myself on 8610 5100.

Yours Faithfully

V A MACDERMID
Partner

Submission in relation to the Federal Government's May Budget Announcement (A Plan to Simplify and Streamline Superannuation).

About Pitcher Partners

Pitcher Partners is a full service accounting firm offering the complete range of advisory services to mid sized companies and organisations. The firm was founded out of a commitment to provide personal service and quality advice to mid sized companies and organisations and is the leading alternative to the Big 4 in Australia.

Pitcher Partners has grown to become the largest Melbourne firm outside the Big 4 with 34 partners and more than 380 professional and support staff.

Pitcher Partners is an association of independent accounting firms, located in Melbourne, Sydney, Brisbane and Perth, and with an affiliated office in Adelaide. This gives clients access to 69 partners and more than 700 professionals located around Australia.

Submission:

Employer ETPs

The Federal Government announced two changes to the treatment of employer ETPs in the 2006 budget. From 1 July 2007, employer ETPs will be taxed more heavily and the ability to roll over an ETP to a superannuation fund will be removed.

While Government has the right to choose where, how and by how much, tax incentives are provided in any given area, our view is that Government must also ensure that any changes should be, as much as possible, fair and equitable to all taxpayers.

An employee who has a contractual right to an employer ETP now has a strong incentive to terminate employment and take their benefit before 1 July 2007. Such contractual rights tend to be more prevalent in large or public companies. There is a risk that such companies may experience a significant loss of Directors or Senior Managers in a short period of time as a result of the proposal. This could have a significant adverse impact on these businesses.

Employment contracts that incorporate employer ETPs are generally designed to encourage the longevity of the employee's tenure with the employer. This is recognised by both the employee and employer when entering the agreement. A major difficulty with the Governments proposal is the comparatively short period of time before the change becomes effective (14 months) compared to the long term nature of the agreements it effects.

There is a basic "fairness" issue here, particularly in relation to arms length employees with existing contractual right to an employer ETP on termination of

employment. These employees have entered into these arrangements in good faith, as have their employers.

For many of these employees it is impossible, or at least impractical, to renegotiate their employment arrangements in a way that restores the value of the remuneration that they have already worked to earn. They are faced with the unenviable choice between ending their employment to retain the value of their remuneration or staying loyal to their employer and suffering an effective reduction of their remuneration.

The most obvious style of remedy is to provide some form of “grandfathering”. This grandfathering could take a number of forms.

The grandfathering could retain the existing tax rules where a contractual obligation to pay an employer ETP was in place on budget night. This would address the short time frame issue while restricting access to the grandfathering. It would preserve the value of employee entitlements in the cases where there is a most obvious issue and avoid the rush to retirement or termination of employment prior to 1 July 2007.

It is likely that the number of people affected by such a grandfathering would be comparatively small and would not be a substantial long term threat to Government revenue.

The grandfathering should also extend to the ability to roll over an employer ETP.

Taxation of Death Benefits

The Government has announced that when a member dies and their entitlement is paid as a lump sum to a “non-tax dependent”, that the benefit will continue to be taxed at 16.5%. This appears to us to be inconsistent with the Governments stated aim to simplify the superannuation system and with their removal of tax on all benefits paid to members over age 60.

Under the proposal, once a member is over age 60 they can, if they wish, withdraw all of their entitlement from the fund tax-free. Having done this, they could give the money to their adult children or retain it to fall to their estate upon their death. However, if they choose to retain the amount within a superannuation fund and draw a pension, the benefit will be taxed at 16.5% if it flows directly to their adult children or to their estate and not on to a tax dependant when they die. For example, if the member withdrew their entitlement from superannuation, earned 10% on the money personally, paid 30% tax, they would have to hold the money outside superannuation for more than 5 years to pay more tax than the lump sum death benefit tax.

This type of analysis would, in our view, lead to the development of all sorts of financial planning practises that encourage pensioners to prematurely withdraw their superannuation entitlements, in order to avoid the lump sum tax. This appears to be quite contrary to Government’s stated policy and objectives.

If lump sums are going to be taxed, administrators or fund trustees will need to retain records of the various components of a members superannuation entitlement in order to be able to determine the taxable and tax free components of the lump sum upon the

member's death. This is contrary to the Government's stated intention of simplifying the superannuation system.

This raises the further question of how to deal with deductible amounts. At present, a deductible amount arises essentially from a members undeducted contributions and the deductible amount forms a tax-free portion of a pension. The entire pension paid to members over age 60 after 1 July 2007 will be tax-free. The deductible amount will, in effect, become irrelevant to the tax treatment of the pension.

However, the calculation of the Unused Undeducted Purchase Price will remain relevant to the taxation of a lump sum death benefit. The fund will be required to continue tracking the deductible amount each year, even when it makes no difference at all to the tax treatment of the pension, because of the possibility that it may have some impact on the taxation of a lump sum death benefit in the event that one is paid.

In our view, the superannuation system would be significantly simplified by making all lump sum death benefits tax free, where the member is over age 60 at death. This would:

- eliminate any bias between choosing a lump sum or a reversionary pension on death,
- encourage members to draw a pension for the whole of their life,
- simplify the administration of member's entitlements, as there would be no need to track or retain the tax components, once they attain age 60.

Proposed New Pension Standards

The Detailed Outline dated May 2006 is not clear in respect of the options that will be available to deal with remaining superannuation assets upon the death of the initial pensioner. Our experience is that pensioners highly value the option available under the existing pension standards to choose to revert their pension to their "dependants", as defined by the Superannuation Industry (Supervision) Act (SIS). The ability to have a pension revert to the pensioner's spouse and/or children fits very well with the pensioners desire to provide for their family in the event of their death.

It appears from our reading of the Detailed Outline, that the Government's intention is to allow a pension to revert only to a dependant per the tax definition (spouse, infant child, financial dependant and interdependant).

This, in our view, would detract significantly from the attractiveness of taking a pension and detract from the member's willingness to commit funds to a long term saving through superannuation.

An appropriate policy would be to allow pensions to revert only to SIS dependants of the original pensioner, and not beyond this group. A pension should not be allowed to effectively revert continuously, each time reverting to a dependant of the current member, and passing from generation to generation for as long as fund assets remain.

Rollover of Pensions after 1 July 2007

We understand that the Government intends that pensions in existence at 1 July 2007, that meet one of the five current pension standards, will be allowed to continue to function in accordance with those pension standards after 1 July 2007 and be “deemed” to meet the new pension standards. This will be very attractive to many pensioners, as they may prefer their existing arrangements.

At present, if a pensioner moving their pension from one fund to another (as may happen if they wish to move from one commercial service provider to another) entails a commutation of the existing pension, a rollover of superannuation monies and the commencement of a new and distinct pension in the new fund.

We are concerned that fund members with pensions in place at 1 July 2007, who wish to change funds or their commercial service provider, will have no choice but to stop their existing style of pension and commence the proposed new style of pension in the new fund, regardless of whether they want to or not. This practical outcome of a forced change in pension styles on rollover may create a practical impediment to normal commercial decision-making by the pensioner. The pensioner may be left with the unenviable choice between a pension style that is less appealing than the one they have, or a service provider that is less appealing than the one they want to move to.

Pensioners should be given the ability to rollover pre 1 July 2007 style pension to another fund or service provider while retaining the original style, terms and conditions of pension and original pension.

Contributions after a Pension commences

At present, if a fund receives new contributions for a pensioner member, the fund is required to carry those contributions in a separate accumulation account until such time as the member draws those contributions as a benefit. This treatment is driven by the need to ensure all superannuation entitlements are ultimately reported and counted for RBL purposes.

RBL reporting will be removed from 1 July 2007. This raises the question of whether, after 1 July 2007, there will still be a need to retain new contributions received for existing pensioners in an accumulation account until some later event.

We see little value in retaining this requirement. In our view, contributions made for a current pensioner should immediately form part of current pension assets. They would then form part of the member’s entitlement at year-end to calculate the next year’s pension.

This could apply equally to existing “pre 1 July 2007” pensions as to new pensions commenced after 1 July 2007. It clearly could not apply to pension styles where the annual pension amount is not derived from the fund assets, such as lifetime pensions. This treatment both simplifies the administration of members accounts and simplifies the calculation of the funds tax liability.

We expect that if the existing arrangement were required to continue, that pensioners would minimise their potential tax liability by simply commencing a new pension whenever a contribution is received. It is much simpler and fairer, that new contributions simply be allowed to form part of current pension assets upon receipt.

Current Pension Exemption

One consequence of the removal of the RBL from 1 July 2007 is that existing pensions with a rebateable proportion of less than one will become tax free the same as previously fully rebateable pensions, so long as the pensioner is over age 60.

However, we think that there is a need to consider the position of existing lifetime pensions. Many existing lifetime pensions have both current and non-current pension assets and only the current pension assets are exempt from tax in the fund. We understand that the distinction between current and non-current pension assets has arisen largely as a defence of the integrity of the RBL system, which measures the RBL value of a lifetime pension based on the first year pension, rather than the underlying assets.

In our view, with the removal of RBLs, the distinction between current and non-current pension assets for lifetime pension should also be removed so that lifetime pensions only have current pension assets the same as all other pensions.

Undeducted Contributions

We have heard from some industry bodies, that they believe that it is Governments view that a member will only be entitled to the “\$450,000 over three years” undeducted contribution limit, so long as they remain eligible to contribute in each of the three years. If this is the case, we are concerned that this will create significant difficulties for the ATO to enforce.

The ATO will not always know whether a given fund member is eligible to contribute in a given year, particularly if a member is aged between 65 and 75. The ATO would need to collect additional information, which in turn fund administrators would need to gather, to enforce this requirement. This is adding complexity and cost rather than simplification to the superannuation system.

Such a rule may unnecessarily inhibit members from making undeducted contributions. Members may not be certain that they will remain in employment for the next three years and at times may have no control over their employment ceasing. Despite contributing in good faith, they may end up bearing tax at top marginal tax rates in the fund in respect of earnings on part of their undeducted contributions.

In our view the eligibility test should occur at the time that the contribution is made.

We have seen in our client base a number of instances where fund members approaching retirement had planned to sell assets they own and contribute the proceeds as undeducted contributions before commencing a pension in retirement. The budget announcement has restricted their ability to carry out their plans. We

think that there is a need for some form of transitional arrangement for people caught in this situation.

Deductible Contributions

The Government plans to remove the limit on tax deductions for contributors and replace this with a limit of deductible contributions that can be contributed for an individual. The ATO will determine when an individual's contribution limit is breached and assess one or more funds at the top marginal tax rate on the amount above the individual's contribution limit. The Government has also announced a 100% deduction for personal contributions where the individual has little or no employer support.

In this environment, it makes little sense to retain the "eligible person" restriction in Section 82AAS.

The ATO will have to develop means to aggregate deductible contributions for an individual, regardless of the number of sources and number of destination funds. Individuals will be entitled to a full deduction for contributions. There is no logical reason to exclude someone from having a personal deduction because they have employer support, when the ATO can enforce an effective deductible cap regardless of the source of the contribution. Employees could achieve the same by salary sacrifice and the Government is happy for this to occur, so there is little threat to Government revenue.

In our experience there are a number of circumstances where an employee could, and would contribute personally, but they cannot salary sacrifice. However, the simplicity and flexibility of allowing deductions to both employers and employees may facilitate greater retirement savings.

Indexation

There is no mention in the Detailed Outline of an intention to index any of the proposed thresholds. We consider that the new thresholds should be indexed to AWOTE, as existing superannuation thresholds are, with the first indexation occurring on 1 July 2008.