TOWER

Submission to Treasury

Response to the paper *A Plan to Simplify and Streamline Superannuation*

9 August 2006

Table of Contents

1. Executive Summary

The need for simplification of the superannuation system has been a major industry issue for many years. Successive Governments have had new policies which have sometimes been beneficial but have resulted in a superannuation system which is extremely complicated and misunderstood by much of the community. Simplification has now been embraced by this Government and serves as the basis for their recently announced superannuation plan - to simplify and streamline superannuation.

This is welcome and TOWER is broadly supportive of the following measures outlined in the plan:

- Abolition of Reasonable Benefit Limits
- No tax on lump sums and pension payments for individuals aged 60 and over
- Extending deductible contributions to age 74
- Extending the co-contribution to self employed individuals
- Allowing self employed individuals to claim a full tax deduction for superannuation contributions
- Consolidation performed by the Australian Taxation Office
- Tax free death benefits for dependants
- Simplification of Eligible Termination Payment components
- Compulsory cashing abolished
- Grandfathering of the asset test exemption for eligible complying income streams

However, there are areas that we believe are contrary to the Government's objectives and may have the unintended consequence of adding back complication and/or may disadvantage segments of the community:

- the operation of the undeducted contribution cap
- the operation of the deductible contribution limit
- complexity of two different forms of taxation on lump sums and pensions
- portability and retriggering provisions
- taxation of employer ETPs

In addition, in our submission we have also outlined some initiatives we feel will further simplify and streamline the superannuation system, such as:

- extend the co-contribution payment to stay at home parents
- indexing the spouse contribution tax offset to increase its attractiveness

- alignment of the taxation treatment for invalidity payments
- allowing employees to claim a tax deduction for contributions to superannuation

It is recognised that some of these initiations may negatively affect the budget but we believe there are many compensating financial and social benefits.

We commend this submission for your consideration.

2. Introduction

We have pleasure in responding to Treasury in regards to the paper titled “A Plan to Simplify and Streamline Superannuation” which was released on 9th May 2006 by the Hon Peter Costello.

This submission is offered on behalf of TOWER Australia Limited, a financial services company which provides personal life insurance, superannuation and retirement solutions to the Australian community.

TOWER Australia is part of the Trans-Tasman financial services organisation, TOWER Limited. TOWER has been operating in Australia for many years providing life insurance and superannuation for both individual and groups. It also provides investment opportunities and presently has more than $3 billion in Funds under Management and has over 100,000 clients in Australia.

TOWER Australia Investments comprises the funds management and investment arm supported by the Beacon platform and the Pivotal Financial Services group of financial advisers. TOWER Australia Investments therefore has knowledge and experience of the full investment cycle.

2.1 Objective

This submission is a response to the Government’s plan to simplify and streamline superannuation as released in the 2006 Federal Budget. In particular it specifically:

- highlights the proposed measures that we support
- examines our concerns with some proposed measures
- explains additional ways of improving the superannuation system to encourage additional contributions to superannuation
- seeks further clarification of some technical details that may have been overlooked

3. Proposed Measures that TOWER support

In principle we support the measures below, although we recognise the need to seek clarification on a number of issues.

- Abolition of Reasonable Benefit Limits
- No tax on lump sums and pension payments for individuals aged 60 and over
- Extending deductible contributions to age 74
- Extending the co-contribution to self employed individuals
- Allowing self employed individuals to claim a full tax deduction for superannuation contributions
- Consolidation performed by the Australian Taxation Office
- Tax free death benefits for dependants
- Simplification of Eligible Termination Payment components
- Compulsory cashing abolished
- Grandfathering of the asset test exemption for eligible complying income streams

3.1 Abolition of Reasonable Benefit Limits

TOWER strongly supports the abolition of Reasonable Benefit Limits (RBLs).

We requested this avenue be explored in our submission to the House of Representatives Standing Committee on Economics, Finance and Public Administration in their inquiry into improving the superannuation savings of people under 40.

We view RBLs as a barrier that deters individuals from contributing to superannuation. Their purpose was to limit the amount of superannuation benefits that an individual can receive at concessional tax rates. RBLs do not encourage extra saving into superannuation as individuals will be penalised if they save past a set limit (which is set at a low level). In effect they can work to punish individuals from adopting a self responsible approach to retirement saving.

By abolishing RBLs the Government is removing a barrier to saving and is also removing needless complexity and confusion for the community. We also believe that RBLs are not required as a system of limiting deductible contributions (either the maximum deductible contribution limits or the proposed $50,000 cap) is in place. This will effectively limit the amount of contributions that will be made in respect of individuals.

The removal of RBLs raises two issues that need attention. First, employees can request that employers cease paying superannuation guarantee if their benefits exceed their Pension RBL. This will need to be removed from the Superannuation Guarantee (Administration) Act 1992. Second, superannuation currently provides asset protection up to the Pension RBL in the event of bankruptcy. This will need to be addressed in the Bankruptcy Act 1966, if RBLs are abolished.

We suggest that there is no benefit in prolonging the operation of the RBL system and therefore suggest that the system be abolished with effect from 1 July 2006.

3.2 No tax on lump sums and pension payments for individuals aged 60 and over

This initiative appears to have wide support as it reduces complexity at retirement and actively encourages individuals to choose superannuation as their retirement vehicle. To subsequently undo this measure would have a very negative impact on the attractiveness and stability of superannuation. For the community to trust in superannuation there needs to be stability. If this measure were undone it would create considerable distrust in superannuation.

This measure removes much complexity for those 60 and over and serves to encourage individuals to work until age 60. It still remains that individuals often think of retirement options when they are 5 to 10 years away from retirement. If an individual was exploring their retirement options they would be faced with more complexity from a taxation perspective than exists currently as 2 different taxation regimes will be present (ie one for individuals aged 60 and above and another for those aged under 60). This will be explored in more detail in section 4.3 of this submission.

3.3 Extending deductible contributions to age 74

Despite the removal of the nexus between work and contributing to superannuation for those aged under 65, the relationship of superannuation to employment through superannuation guarantee and salary sacrifice benefits remains. We support this proposed measure as it facilitates older individuals to continue working and contribute to superannuation, whether they are self employed or an employee. This measure is appropriate and relevant as life expectancies are increasing, people are working longer and more funding is required for retirement.

This proposed measure will allow deductible contributions (ie salary sacrifice, voluntary employer contributions and personal deductible contributions) to be made by or in respect of individuals aged up to 74. This is a strong message is for individuals to work longer and to accumulate retirement savings.

3.4 Extending the co-contribution to self employed individuals

We support this measure as we requested this in our submission to the House of Representatives Standing Committee on Economics, Finance and Public Administration in their inquiry into improving the superannuation savings of people under 40.

Extending the co-contribution to self employed and substantially self employed individuals would promote superannuation and would serve as an encouragement for those that would benefit from the co-contribution payment rather than a tax deduction. The proposal to also allow self employed individuals to both claim a tax deduction for deductible contributions and to also receive the co-contribution for personal non-deductible contributions increases the flexibility. It also encourages this segment of the community to make contributions to superannuation when they are currently under no obligation to do so as they are not subject to superannuation guarantee.

We have had questions as to why this initiative has not been extended to self employed people. The proposed measure has been welcomed by financial advisers as it may translate into increased retirement savings for self employed individuals.

However, we believe the scheme should be extended to stay at home parents. This will be discussed in section 5.1 of this submission.

3.5 Allowing self employed individuals to claim a full tax deduction for superannuation contributions

The current rules limit the amount of contributions made by self employed and substantially self employed individuals. Since 1 July 2002 only the first $5,000 of superannuation contributions have been fully deductible (prior to this the figure was $3,000). This established the amount of contributions that were typically made by self employed individuals as any superannuation contribution over this amount was not fully deductible (only 75% was deductible).

The introduction of allowing a full tax deduction in relation to superannuation will be positive and will encourage self employed individuals to contribute to superannuation. This is needed as these individuals have no requirement to pay themselves the compulsory superannuation guarantee. It is an encouragement for them to plan for retirement in a tax effective manner. It also can encourage the provision of insurance (ie death, total and permanent disablement and income protection) in superannuation.

3.6 Consolidation performed by the Australian Taxation Office

At present individuals each have on average three superannuation accounts. Some may wish to reduce their risk by diversifying their superannuation accounts. However, we believe this may be attributable to a very small proportion of individuals and that the majority are due to changing jobs and having a lack of awareness and/or interest in their superannuation. The problem of multiple accounts is widespread.

We support the ATO becoming more involved in the consolidation process. This is very helpful but we don't believe it fully addresses the problem as the number of lost member accounts in the ATO's Lost Member Registry would not accurately reflect the number of lost members, as members may not be identified as lost. We feel that the Government should also launch an awareness campaign to highlight the need to consolidate superannuation. The campaign could even be incorporated into an individual's tax return process on an annual basis.

3.7 Tax free death benefits for dependants

Death benefits represent a convoluted part of the superannuation system due to their interaction with RBLs. To illustrate this, when paying out a death benefit only up to the deceased's pension RBL is tax free if paid to a dependant for tax purposes (as outlined in the

Income Tax Assessment Act 1936 section 27A). In determining how much is within this limit, the used portion of the deceased's pension RBL has to be ascertained (ie the previously received benefits) as the member may have used some of their pension RBL prior to death. The previously received benefits also need to be indexed if they were taken at least 12 months ago.

The remainder of the benefit that exceeds the deceased's pension RBL, if any, is an excessive component and will be taxed at either 39.5% or 46.5% - this also involves another step where it needs to be determined what components the ETP would have been if it were not excessive. This involves the complex computation of the value of taxed and untaxed elements of the post June 1983 component. The portion that would have been post June 1983 taxed element would attract the rate of 38.5% and the balance of the excessive portion would attract tax at 46.5%.

This is not easily understood by most. But presently individuals need an understanding so they'll be aware of the taxation treatment of their superannuation in the event of their death. This enables one to be informed so they can adequately plan for their family.

This complexity and confusion will end if RBLs are abolished and death benefits are tax free.

We support this proposal but seek further clarification on the taxation treatment of death benefits when paid to non dependants. The Government paper states that death benefits paid to a non-dependant would be taxed in the same manner as other superannuation payments paid to someone in the 55 – 59 age group, except the entire taxable component would be taxed at 15%. This is straightforward for superannuation investment balances, but clarification is needed in relation to death benefits that are funded partially and/or fully from insurance proceeds. Presently these benefits are treated differently from a taxation perspective when compared to the investment component of a death benefit as they may represent an untaxed element of the post June 1983 component. The Government paper was silent on this issue and we highlight it as an area that needs to be explored, clarified and explained to the industry.

3.8 Simplification of Eligible Termination Payment (ETP) components

The proposal to condense the eight ETP components into two components we view favourably in principle as it will simplify superannuation for the community.

A possible problem is the time allowed to change the ETP components and to calculate the pre July 1983 component at a fixed date (yet to be legislated) to transform this into a fixed dollar exempt component. For older style superannuation funds, it may be time consuming to change the operating systems and the calculation of components can be a manual process. Given that legislation may only be passed in the autumn parliamentary sittings, it may be very hard to update systems and manually calculate the pre July 1983 component for all members concerned, so we are ready for 1 July 2007. We believe that an extension of time (ie 1 January 2008) should be granted to allow superannuation funds more time to update systems and to accurately calculate the ETP components of members.

We also seek clarification in relation to the post June 1994 invalidity component which is attributed to some total and permanent disablement cases. In the proposed system this is part of the exempt component. Will the current rules (outlined in the Income Tax Assessment Act 1936 section 27G) that provide the method of calculation for this component still apply or will the entire benefit be an exempt component? If this current method remains, we recommend an extension of the component to self employed individuals as this is currently not permitted. Further discussion in relation to this issue is contained in section 5.3 of this submission.

We also seek clarification on the taxable component threshold (ie $135,590). Does it operate similar to the existing ETP tax free threshold, in that previous benefits (including redundancy) will count toward the threshold and it will continue to be indexed yearly in line with average weekly ordinary time earnings (AWOTE).

3.9 Compulsory cashing abolished

We support this measure. In order for superannuation to become the retirement vehicle of choice (which can be viewed as favourable due to its associated preservation rules and superannuation guarantee) it must have flexibility to deal with different stages in an individual's life. Removing the requirement for individuals aged 65 and over to meet a work test will provide more time and flexibility when making decisions. It will allow individuals to keep their money invested in superannuation instead of spending it unnecessarily.

3.10 Grandfathering of asset test exemption for eligible complying income streams

With the proposal of extending the age pension assets test taper rate and removing the assets test exemption (currently 50% exempt) for complying income streams; we support the adoption of grandfathering. This will ensure that individuals' retirement strategy will not be disrupted and current and future age pension entitlements will not be reduced from this new proposal.

4. Our concerns with the new measures

In reviewing the detailed Budget Plan there were measures that have the unintended consequence of adding further complication to the superannuation system and have imposed a costly administrative burden on superannuation funds. This is not in the best interest of all members. The measures where we feel further refinement is needed are:

- the operation of the undeducted contribution cap
- the operation of the deductible contribution limit
- complexity of two different forms of taxation on lump sums and pensions
- portability and retriggering provisions
- taxation of employer ETPs

4.1 Undeducted contribution cap

The establishment of a cap on the amount of undeducted contributions that can be made was unexpected. Individuals have not been given the opportunity to adequately prepare for this significant change given that it effectively applies from Budget night if legislated. Furthermore, individuals have planned ahead for their retirement and had relied on making undeducted contributions to effectively fund their retirement via superannuation. Given that the measure applied from Budget night it has left some in a dilemma. It has also penalised some segments of the community that have adopted a self responsible approach to saving, who have perhaps sacrificed along the way to arrive at their current financial situation.

From our informal discussions with financial advisers and the industry it has become evident that certain groups have been disadvantaged by this proposal. They fall into the following categories:

- people who have come into an inheritance and wish to contribute to superannuation (given that house prices are quite high the averaged cap amount of $450,000 and certainly the annual cap of $150,000 may not be sufficient)
- people who have entered into a retirement plan which is now disrupted
- widows that come into an inheritance
- individuals who receive a windfall
- investors who have planned to realise assets and invest the proceeds in superannuation
- individuals who have received a compensation payment for permanent incapacity

- singles who only have ‘one cap’ to use

We welcome the Treasurer’s press release which was released on 13 June 2006 as it provided much needed clarification on how the proposed cap should work. Namely that:

- the cap can be averaged over three years to allow larger one off payments
- undeducted contributions made between 1 July 2005 and Budget night 9 May 2006, would not count towards the cap

The release of this information was timely as the community had more information which allowed them to plan appropriately. Prior to this date the concept of averaging was just a consideration of the Government.

Despite the information in the press release, some uncertainties still remain. These are:

- are spouse contributions and co-contributions also included in the cap?
- are overseas superannuation transfers included in the cap?
- will the $150,000 cap be indexed and how often?
- how will the contribution rules be monitored if a person uses the averaged cap (this will be very problematic if the person rolls over their superannuation or subsequently commences a retirement income stream)?

In principle we support the introduction of a cap on undeducted contributions but we feel the amount of the cap is insufficient. We propose that the Government explore other options such as increasing the quantum of the cap or allowing averaging over a longer period of time (eg 5 years).

The proposed administration of the undeducted contribution cap is one area that we do not support. It requires that superannuation funds deduct tax at the top marginal tax rate for earnings on contributions that exceed the cap, as advised by the Australian Taxation Office. In addition, superannuation funds will need to refund these excess contributions and earnings on these contributions to the member. We do not agree that the administration should be borne by the superannuation fund; rather we feel it should be the Australian Taxation Office and the individual that is accountable.

If the superannuation fund is responsible, it would be akin to the re-introduction of surcharge which was described in Bills Digest No. 169, 2004/2005 as:

> *“…an extremely unpopular impost for a number of reasons:*
> *• it is complex and costly to administer and collect*
> *• its collection costs are carried by all fund members, most of whom do not have*

surcharge deducted from contributions made on their behalf"

The proposed administration of the undeducted contribution cap will add back complexity and expense to every member (even those that do not make undeducted contributions or exceed the cap). To implement this measure will be extremely complex especially where multiple contributions and multiple funds are involved. There will also be a huge "chase to recover benefits" especially where the individual is transferring whole or part contributions to other superannuation funds. If the industry's surcharge experience is anything to go by, this will be an administrative "nightmare". We propose that other avenues be explored that involve the administration being performed by the Australian Taxation Office and the individual concerned.

We therefore propose that the tax payable on any excess over the cap be carried by the individual and not the superannuation fund. Individuals who exceed the cap should be able to request redemption of the excess to fund their tax liability. If the proposed system of taxing the superannuation fund is introduced, those funds which simply provide death and disability cover to the member should be excluded from the recovery process. These funds do not have the investment balances to fund the additional tax payable.

4.2 Operation of Deductible Contribution Limits

The replacement of the maximum deductible contribution limits with a streamlined $50,000 annual limit on deductible contributions, we view favourably in principle, but feel the current proposals need more refinement.

Adopting the current budget proposal will generally result in individuals aged under 50 having a larger limit on the amount of deductible contributions that can be made in respect of them. However, we believe this limit will not be adequate for those aged 50 and over. The introduction of transitional rules we view favourably, however they do not go far enough as they only allow a higher limit of $100,000 to be used until 30 June 2012.

Under the Budget proposal, from 1 July 2012, individuals aged 50 and over will only be allowed a maximum deductible limit of $50,000 which may not be sufficient. The proposal also assumes that individuals need the same limit regardless of age, which experience suggests is not the case. In the earlier age brackets it is widely recognised that these individuals do not have the means to contribute additional amounts (and certainly not much) as they have competing priorities such as raising a family and paying off the mortgage.

It is in the later years that people need higher amounts as this is the time when the majority of individuals start to seriously consider their superannuation and retirement needs. As they may not have actively contributed to their superannuation before they may wish to make large superannuation contributions (as they are currently allowed) so they have sufficient funds for retirement. For this reason we propose that other avenues be explored such as:

1. A streamlined $100,000 limit for simplicity which embraces the needs of individuals aged 50 and over
2. A two-tiered approach – individuals under 50 have a $50,000 limit
   – individuals 50 and over have a $100,000 limit

Another aspect of this measure that we do not support is the administration of the proposed system, for the same reasons outlined above in section 4.1. We believe the administration should be performed by the Australian Taxation Office and the individual.

4.3 Complexity of taxation on lump sums and pensions

As stated previously we are very supportive of lump sums and pension payments being tax free from age 60 and feel that this will help restore the attractiveness of superannuation. However, it will create much complexity and confusion for individuals who are considering retirement shortly before age 60. They will have increased choice (and associated consequences) by the two tiered taxation approach that will exist:
- the simple regime for those aged 60 and over; and
- the complex regime that exists for those aged less than 60.

This has inadvertently added another layer of complexity that currently does not exist.
If an individual was contemplating retirement at age 55 they would be faced with the following broad choices currently and with the proposed rules:

Current Choices	Proposed Choices
• Retire at age 55 and over and commence an income stream • Retire at age 55 and over and take a lump sum • Retire at age 55 and over and take a combination of lump sum and income stream	• Retire at age 55 – 59 and commence an income stream and potentially be taxed on the benefit • Retire at age 55 – 59 and take a lump sum and possibly be liable for lump sum tax • Retire at age 55 – 59 and take a combination of lump sum and income

	stream • Wait and retire at age 60 and over and commence an income stream which will be tax free • Wait and retire at age 60 and over and take a lump sum which will be tax free • Wait and retire at age 60 and take a combination of lump sum and income stream

This two tiered approach will exist for the next decade due to the preservation age graduating from age 55 to age 60. When the preservation age that applies is age 60, the problem of the 2 tiered approach will diminish. But the next ten years spell complexity for individuals planning for retirement.

To lower the age of tax free treatment for lump sums and pension payments to the preservation age is one area that could be explored. This will bring simplicity to an area that will be quite complex. We also feel that individuals will continue to work past age 55 if they have insufficient savings, therefore lowering the age will not result in everyone retiring at age 55. If the Budget proposal is passed one thing that certainly will need attention is community education to ensure individuals can fully understand the options and the related consequences.

4.4 Portability and retriggering provisions

The reduction in the time allowed to transfer superannuation benefits is an initiative that we support as it will be in the best interest of members. We do however foresee issues associated with removing the 'retriggering' provisions. If these were removed all benefits would have to be transferred within 30 days of the initial request. This would not be achievable if the member has not provided requirements or was responsible for timely delays. Therefore if the 'retriggering' provisions are removed from the legislation there should be certain situations (eg client delay and severe market movements) that attract an exemption from the rules.

4.5 Taxation of Employer ETPs

We do not support the proposed changes to the taxation treatment of employer ETPs as it may significantly reduce an individual's benefit. For example, if an individual aged 55 received an employer ETP (of say $250,000 after 20 years of service) as a result of redundancy they would be affected in the following way:

Current Rules	Proposed Budget Changes
First $135,590 x 15% = $20,338.50 Remaining $114,410 x 30% = $34,323 Taxation Liability = $54,661.50 Net Benefit = $195,338.50	First $140,000 x 15% = $21,000 Remaining $110,000 x 45% = $49,500 Taxation Liability = $70,500 Net Benefit = $179,500

In this case the individual would have a reduction in the overall payment of $15,838.50.

We feel that the proposed threshold of $140,000 will be too low for many individuals and that the Government should explore the option of increasing the threshold.

One area that has not been adequately addressed is employer ETPs that are payable upon the death or invalidity of an employee. This situation can arise when an employer has included life insurance as an employee benefit. As the employer is the policy owner they receive the insurance proceeds. They then will remit this money either as a death benefit ETP (as a result of the employee's death) or as an employer ETP (as a result of disability).

We believe death and disability benefits should have the same taxation treatment that is proposed within superannuation, so that families and individuals will not be penalised because their insurance in owned by the employer rather than their superannuation fund. Under the rules existing prior to the May 2006 Budget, death and disability benefits paid by employers were taxed in the same way as the payment of these benefits from a superannuation fund. It is submitted that this consistency should continue.

5. Ways of encouraging additional contributions

The Budget proposals will go a long way in making superannuation more attractive to the community and may change views so people take an active interest in their superannuation. However we feel that these measures will not go far enough and that the following measures should be explored further:

- Extending the Government Co-contribution
- Indexing the Spouse Contribution Tax Offset
- Aligning the treatment of invalidity payments for self employed
- Extending the option of claiming a tax deduction to employees

5.1 The Government Co-contribution

We support the Government for introducing this initiative in July 2003, and subsequently increasing the eligibility rules in July 2004 so that more low to middle income earners could take advantage of this benefit. We are also very supportive of this initiative being extended to self employed people (as outlined in the Budget proposals), as we requested this avenue be explored in our submission to the House of Representatives Standing Committee on Economics, Finance and Public Administration in their inquiry into improving the superannuation savings of people under 40.

The Co-contribution has raised community awareness about superannuation and has proved to be a popular initiative with over 1.51 million Australians receiving the co-contribution in the first two years of its operation. In this period the Government paid approximately 1.046 billion in co-contributions. We propose that the measure be extended further to stay at home parents by removing the work test requirement that currently exists.

If this was extended it would particularly benefit women who tend to have less superannuation than men. One of the reasons for this anomaly is that women are generally not engaged in full time employment for as long as men, due to child birth and child rearing. If the co-contribution was extended the benefits to their superannuation would be quite significant especially when the money may be compounding for a longer period of time. This would work towards bridging the gap that currently exists between men and women's superannuation. It would also increase the financial independence of women and encourage them to be active participants in their superannuation.

Our recommendation of removing the work test to extend the co-contribution to stay at home parents was also endorsed by the House of Representatives Standing Committee on Economics, Finance and Public Administration, in their report titled *Improving the Superannuation Savings of People Under 40*.

5.2 Spouse contribution rebate

The Budget announced a raft of beneficial proposals to the community although one area we feel has been overlooked is the spouse contribution tax offset.

The spouse contribution rebate was introduced in 1997. It provided that if a spouse or defacto made a contribution into their spouse or defacto's superannuation account they would generally be entitled to an 18% rebate of the contribution, up to a maximum rebate of $540. This was based on the provision that the receiving spouse did not have assessable income and reportable fringe benefits exceeding $10,800. The amount of the rebate reduced when the $10,800 threshold was passed, until it phased out completely when the receiving spouse's assessable income and reportable fringe benefits reached $13,800.

Now approximately eight years later the relevant thresholds and the amount of the rebate are still the same. We believe the thresholds and the amount of the rebate should be increased to bring them in line with inflation. This would serve to make this initiative more attractive to individuals and will allow parents staying at home to engage in part time employment which will allow them to earn more income which is very important given the high levels of debt that prevails in Australia.

5.3 Aligning the treatment of invalidity payments for self employed

The taxation treatment of invalidity payments has long been an issue for self employed individuals, the superannuation industry and financial advisers. When such a benefit is paid from a superannuation fund, the post June 1994 Invalidity component can be payable if the individual meets the eligibility requirements. Eligibility for this component is very significant as it is not counted towards an individual's reasonable benefit limit and is tax free. In the current law, inequity exists for self employed individuals who are not incorporated as the wording of the legislation does not allow for these individuals to qualify for the post June 1994 Invalidity component.

Section 27G of the Income Tax Assessment Act 1936 outlines the current eligibility requirements that must be met by an individual to be eligible for a Post June 1994 Invalidity component. Broadly, the three following criteria should be met by the member:

1. The termination of employment is because of the individual's permanent disability.
2. The termination of employment is before the date the individual would normally have retired because of age or period of service (early retirement is usually before age 65 or the term of a contract).
3. Two legally qualified medical practitioners must certify that the individual's disability is likely to prevent the individual from ever being employed in a capacity for which the individual is reasonably qualified because of education, training or experience. Generally, this means the individual is unlikely to ever be employed again.

Self employed individuals who are not incorporated (ie sole traders) will not be able to satisfy the conditions as they are not seen to effectively terminate employment as they are not technically viewed as employed by an employer. The inequity is evident when the self employed individual is incorporated. In this situation they may be viewed as an employee and therefore may be eligible to receive a tax free component (ie the post June 1994 Invalidity component).

We believe it is vital that the tax treatment of invalidity payments be aligned so unincorporated individuals can also be eligible for the post June 1994 Invalidity component.

Our recommendation of aligning the tax treatment of invalidity payments of the incorporated and unincorporated self employed was also endorsed by the House of Representatives Standing Committee on Economics, Finance and Public Administration, in their report titled *Improving the Superannuation Savings of People Under 40*.

5.4 Extending the option of claiming a tax deduction to employees

The final recommendation we would like to make is to extend the ability to claim a tax deduction for superannuation contributions. Currently employers, self employed, substantially self employed and unsupported individuals not eligible to claim the Government Co-contribution are able to claim a tax deduction.

In some cases employees can implement an effective superannuation salary sacrifice arrangement to derive the same benefit of reducing their level of taxable income. It is not compulsory for employers to offer salary sacrifice and indeed it is not offered by all employers. This leaves employees depending on their employers.

If individuals could claim a tax deduction for making their own contributions to superannuation it would encourage more individuals to take an active interest in their superannuation. One of the reasons why investing in property is so popular is that it attracts tax deductibility. If the same could be extended to superannuation the profile would be lifted and individuals would take more ownership of their superannuation and may contribute to superannuation. It would also help those employees who cannot salary sacrifice.

In doing this, the Government could set a universal limit for both employer and personal contributions. Employees should not be disadvantaged just because their employer does not wish to offer salary sacrifice arrangements.

6. Conclusion

We support many of the initiatives proposed in the 2006 Federal Budget and applaud the Government for taking such a bold and proactive approach to tackle the issues of complexity, inequity and barriers to saving that currently exist within superannuation. In particular we support the proposed taxation changes to lump sums and pension payments, changes for self employed individuals, abolishment of RBLs, tax free treatment of death benefits and the increased ATO involvement in consolidation.

There are also certain issues which we do not support such as the undeducted contribution cap and the deductible contribution limit and their proposed administration, removing the 'retriggering' provisions for superannuation transfers and changes to the taxation of employer ETPs. In addition, the proposal of a new regime to tax superannuation lump sums and pension payments, whilst sound, will create unexpected complexity and confusion for the community. If this measure is passed then extensive education is needed to avoid confusion.

We also believe that other areas need to be explored to increase the attractiveness of superannuation such as extending the co-contribution and tax deductions, removing the inequity that exists for unincorporated self employed individuals in relation to invalidity payments and indexing the spouse contribution tax offset so it maintains an attractive incentive.