



A PLAN TO SIMPLIFY AND STREAMLINE SUPERANNUATION

Submission by Holding Redlich

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1 INTRODUCTION

This submission is directed towards a single issue arising out of the proposals contained in the Government's paper "A plan to simplify and streamline superannuation".

We submit that older Australians without superannuation who were prevented from building up superannuation during their earlier years because of the application of the superannuation contribution rules should be provided with an opportunity to transfer assets into a superannuation account so as to access the new tax regime to apply in respect of superannuation for retirees aged 60 and over.

2 SUBMISSION

2.1 The issue – inequity between older Australians with superannuation and those without

The announcements made regarding superannuation in the 2006 Federal Budget, and set out in more detail in the paper "A Plan to Simplify and Streamline Superannuation" focus on the position of retirees who are funding their retirement income needs, in whole or in part, through superannuation. However, many self-funded retirees and older Australians do not have superannuation interests, and

those who are not dependent on Centrelink payments are funding their income needs in their later years from assets held outside superannuation.

There have long been significant differences between the tax treatment of the incomes of those retirees who have superannuation and those who do not. Notably, retirees who are in receipt of a superannuation pension are able to enjoy a 15% rebate in respect of pension income to the extent that this falls within the relevant Reasonable Benefit Limit. Further, income earned and gains realised in respect of the superannuation assets funding their pensions is free of tax. Retirees and older Australians who receive income from non-superannuation investments pay income tax on that income at marginal rates, and pay capital gains tax on realising such investments.

If the proposals foreshadowed in the Budget are implemented, retirees aged 60 or over will receive superannuation pensions (and, indeed, lump sums) free of tax, and the earnings and gains on their superannuation assets (once the retiree has commenced their pension) will (as is the case at present) be free of tax. Australians of the same age who receive income from non-superannuation investments will continue to pay tax at marginal rates. They have also paid tax at marginal rates on the income earned by their investments for their entire period of ownership, while income from assets held within superannuation during the accumulation phase is of course taxed at only 15%. Further, those people have not had the benefit of tax deductions for superannuation contributions.

There will therefore be substantial differences in the net position of those retirees who receive their retirement income from superannuation, and those Australians who receive income in their later years from non-superannuation sources.

While it might be argued that there is no inequity in providing tax concessional treatment for those people who have chosen to take advantage of the opportunity to build up savings within superannuation, and withholding that treatment from those who chose not to take up that opportunity, there is a group of older Australians who were prohibited from contributing to superannuation altogether, because they did not meet the work test which applied up until 30 June 2004. Until then, only people who met restrictive employment tests were able to make contributions to superannuation.

There were many people who did not meet these tests, including:

- women who were not in the workforce because they were engaged full time in bringing up children;
- people who were unable to work by reason of incapacity;
- people who had been retired from the workforce for more than two years (and there are many retirees who left the workforce before superannuation was effectively made compulsory within employment with the introduction of the Superannuation Guarantee in 1992).

These people were therefore locked out of the superannuation system because they were not engaged in paid employment. There can be no suggestion that they should be excluded from concessional tax treatment on their retirement income because they chose not to avail themselves of an opportunity to contribute to superannuation, because that opportunity was specifically denied to them.

In its paper “A more flexible and adaptable retirement income system” issued in 2004, prior to the abolition of the work test for people under age 65 wishing to contribute to superannuation, the Government stated that:

“Every Australian should be able to save for their retirement in a prudentially supervised and concessional tax environment.”

It was recognised that the work tests in place prior to 2004 were unduly restrictive, and were preventing some groups within the community from participating in superannuation. This was not only inequitable, but increased the likelihood that members of those groups would be unable to self-fund their later years, and would be forced to rely on Centrelink payments.

Traditionally, transitional provisions have been put in place when changes to the superannuation system have been made, so as to ensure that these changes do not disadvantage those who have made their arrangements and plans on the basis of existing rules. However, there has been less emphasis on ensuring that those who have previously been excluded from accessing superannuation tax advantages are able to be compensated for the effects of that exclusion when rules change. Accordingly, there were no transitional provisions introduced with the 2004 changes to allow people who had already reached age 65 and were not working to “catch up” by making superannuation contributions in respect of earlier years in which they had been prohibited from making contributions.

Some of these people rely on Centrelink payments, but others fail to qualify for such benefits because they have investments in excess of the amounts allowed under Centrelink assets tests. These investments might have been accumulated through savings set aside by the individual during an earlier working life, from insurance proceeds, from amounts inherited from a spouse, or from other sources. The income received is of course reduced by the tax which is payable at marginal rates. Further, many such retirees are now at a stage of life where they are gradually selling shares and other investments in order to release cash needed for day to day living expenses. These dispositions attract capital gains tax, further reducing the resources available to the relevant retirees.

2.2 Hypothetical case study

On 20 May 2006, The Age newspaper published an article written by Heather Gray of Holding Redlich, in which she set out a hypothetical case study to illustrate the inequity which would exist after 1 July 2007 as between retirees with super and those without. We have set out the relevant part of the article below:

"Dora" is 75 years old.

She was widowed at age 50 and inherited some investments from her husband. Living on the income from these resources, she finished bringing up her teenage children, by which time she had been out of the workforce for more than 20 years. Her skills and qualifications were well out of date, and in any case she was busy doing volunteer work and looking after her elderly parents. Paid employment of any sort, let alone a job which would fit around these commitments, was impossible to find.

Anxious about providing for herself in her later years, she asked her accountant if she could contribute to superannuation from her investment income. The answer was no - she did not meet the Government's work tests (that is, she had not worked in the previous two years, she wasn't on parental leave from a job, and she hadn't ceased work because of ill-health).

When Dora heard that the work test was to be abolished from 1 July 2004, she hurried back to her accountant. But the news was still discouraging. Superannuation remained closed to her, as she was now aged over 70 and could only make contributions if she had worked at least 40 hours over 30 consecutive days in that year.

Dora is earning around \$40,000 per year from her investments. This year, she will pay tax and Medicare levy of around \$6,500 (this would be more without the benefit of some franking credits). She is not eligible for the Senior Australian's tax offset, and certainly does not qualify for an age pension.

"Tom", who is Dora's neighbor, met the superannuation work tests. He has accumulated assets of a similar value, but holds these in a superannuation account. Tom receives allocated pension payments giving him the same gross income as Dora, but he currently enjoys a 15% tax rebate on those payments. From 1 July 2007, Tom will receive the whole of his pension payments tax free. Dora will continue to pay tax on her income, at the standard marginal rates.

Compared to Tom, Dora will be around \$110 per week worse off after 1 July 2007. If she lives for another 10 years, she will have paid over \$57,000 in tax (at today's figures), while Tom pays nothing.

Since that article was published, we have been contacted by a number of older Australians who find themselves in a position similar to that of "Dora" in the case study. They have indicated to us that while the existing differential tax treatment between themselves and those of their peers with superannuation savings seems to them to be unfair, they see the differences that will exist post-1 July 2007 to be inequitable in the extreme.

2.3 Recommendation

We recommend that older Australians who have been unable to contribute to superannuation by reason of the operation of the contribution rules in effect while they were aged under 65 be permitted to transfer assets into superannuation.

We suggest that transitional arrangements be established to allow for a transfer of assets into superannuation in the following circumstances and on the following terms:

- Those using the transitional arrangements should have been aged 65 or over on 1 July 2004, and have been excluded by the operation of the contribution rules under the Superannuation Industry (Supervision) Act 1993 (Cth) and Regulations from making contributions to a superannuation fund throughout a prescribed period preceding 1 July 2004 (perhaps two years).
- Cash or assets should be permitted to be transferred into a superannuation account up to a prescribed value (perhaps the 2006-2007 Pension Reasonable Benefit Limit). The limit applicable to undeducted contributions should not of course apply to such transfers.
- There should be an exemption from capital gains tax in respect of any such transfer of assets, or disposition of assets made where the proceeds are immediately transferred into a superannuation account under the transitional arrangements, and no other taxes or charges should be imposed by the Federal Government in respect of any such transfer.
- The Government should liaise with State and Territory Governments to determine whether such transfers could be permitted to be made free of state duties.
- There should be a prescribed period during which the transitional arrangements apply – perhaps two years from 1 July 2007.

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