CONSULTATION PAPER

ING
> INVESTMENT > INSURANCE
> SUPERANNUATION

9 August 2006

A Plan to Simplify and Streamline Superannuation

ING Australia (ING) welcomes the opportunity provided by Treasury to comment on the proposed policy outlined in May 2006 by the Government in *"A Plan to Simplify and Streamline Superannuation"*.

ING supports the reforms proposed and looks forward to a simpler and more streamlined superannuation system.

ING has had input into, and supports, the IFSA submission to Treasury of 9 August 2007. However, we recognise that a whole of industry submission cannot address all issues relevant to all industry participants and this submission is designed to highlight issues of particular significance to ING and the clients whose assets we manage. Further, this submission addresses some additional technical issues which were not the focus of the broader IFSA submission.

1. Post tax contributions limits

1.1 Proposed 10 May 2006 start date

On 14 June 2006, the Treasurer announced that contributions made prior to 10 May 2006 will not count towards the 2005/06 annual limit. It is preferred if the proposed cap on post-tax contributions applies from 1 July 2006 for reasons outlined below:

i.) Assume a 55 year old taxpayer has personally made $200,000 in contributions for the year ($100,000 of which was made after 9 May 2006). The taxpayer intends to claim a $100,000 tax deduction under section 82AAT. How much of the post-tax contributions will apply in respect of the 10 May to 30 June period?

In our opinion, current tax law does not necessarily apply the deductible contribution on a 'first in' basis. This means, the trustee may treat the 10 May to 30 June contributions as the deductible (or after-tax) contributions.

ii.) Costly IT upgrades (borne by all members of superannuation funds) may need to be developed to segregate 2005/06 post-tax contributions made on or after 10 May 2006 from those made earlier on in the income year.

iii.) There is no evidence of significant contributions being made in the period 10 May 2006 to 30 June 2006 and therefore the impact of this proposed change is minor.

1.2 Government co-contributions

Any new legislation should make sure to exclude the Government co-contribution from the cap.

1.3 Bankruptcy and marriage breakdown

The rules surrounding the refund of surplus contributions should capture the event of a bankruptcy or marriage breakdown.

ING Life Limited
ABN 33 009 657 176
AFSL 238341
347 Kent Street,
Sydney NSW 2000
Tel: 02 9234 7696
Fax: 02 9234 8936

Important issues requiring attention include what happens if the fund member becomes bankrupt **before** or **after** the surplus contributions have been identified by the relevant authority?

Alternatively, what happens if the fund member was in the process of a marriage breakdown and there was a flag on the member's account as at the time when the surplus contributions are identified by the relevant authority?

1.4 Contributions-splitting

Any new legislation dictating the refund of surplus contributions should cater for circumstances where the surplus contributions **have** or **are in the process of being split** in favour of an eligible spouse?

In the event that the split has already been processed, what is to happen where the receiving spouse is no longer the spouse as at the time in which the surplus contributions have been identified?

1.5 Insurance premiums

It is important that any "refund" of contributions is not borne by the trustee of the superannuation fund. For example, assume an individual made $450,000 in contributions last financial year to ABC superannuation fund. This contribution represented last year's entitlement as well as the current years and the next. The same individual has just established insurance cover via XYZ superannuation fund. The cover is being financed through ongoing post-tax contributions – these are surplus contributions.

Our preference is for the surplus contributions to be refunded from another superannuation fund if that other superannuation fund contains an 'exempt' component.

1.6 Work test for 65 and over

It has been proposed that the work test must be satisfied in a future year if that future year's contribution entitlement is to be brought forward. Whilst plausible, this suggestion is likely to lead to complexities in policing this regime.

Under current law, it is possible to make the contribution if the individual has worked at least 40 hours over 30 unbroken days in the income year. A preferred option would be to broaden the existing work-test requirements so that a future year's work-test can be satisfied in the current year. If an individual wishes to bring forward a future year's contributions entitlement, they should be able to do so if they bring forward that future year's work-test.

1.7 Possible need to amendment to definition of undeducted contributions

Will a contribution made by a third party for which no tax deduction is allowed be dealt with as a post-tax contribution, where the contribution is <u>not</u> one of the following:

- Child
- Employer
- Spouse
- Transfer from a foreign superannuation fund.

Such a contribution will still be classed as a taxable contribution under section 274 of the Income Tax Assessment Act 1936, however the contribution may simultaneously satisfy the definition of undeducted contributions. This is because paragraph (e) of the definition of

ING Life Limited
ABN 33 009 657 176
AFSL 238341
347 Kent Street,
Sydney NSW 2000
Tel: 02 9234 7696
Fax: 02 9234 8936

undeducted contributions does not exclude taxable contributions as defined under section 274. To avoid any confusion, the definition of undeducted contributions should be amended accordingly.

1.8 Clearly defined process required to deal with undeducted contributions

Based on current processes, superannuation funds will have difficulty in determining which benefits can be claimed as a section 82AAT and more so, which surplus post-tax contributions are to be refunded. This matter is also expected to impact contributions-splitting purposes and the order in which surplus post-tax contributions are to be refunded.

1.8.1 Withdrawal (other than refunds) of an 'exempt' component

Difficulty will arise when a fund is to determine the remaining contributions received during a particular financial year if withdrawal(s) of exempt components have been made.

It is important the fund is able to determine will be classed as post-tax contributions for section 82AAT purposes (personal contributions) and contributions-splitting purposes (personal, spouse and co-contributions).

For example, assume the fund had $300,000 as an 'exempt' component of which $100,000 represented a contribution made to the fund. The $100,000 contribution was personally contributed by the member. An $180,000 'exempt' amount has been withdrawn from the fund since making the contribution. With respect to the remaining $120,000 exempt amounts in the fund, how much represents the remaining personal contributions in the fund for section 82AAT purposes?

It is suggested that if a fund has received post-tax superannuation contributions during the course of a financial year, any withdrawals will first come from the portion of the exempt component that did not represent contributions to the fund. This approach will have broader application and will assist in identifying contributions available for contributions-splitting purposes.

1.8.2 Refunding post-tax contributions

In addition to the issues outlined above, there are many practical issues relating to refunds of surplus post-tax contributions and it is strongly preferred that legislation be enacted to outline a clearly defined process.

For example, assume in a particular financial year, spouse contributions and personal contributions were made (not necessarily to the same fund). If it is determined that a refund of contributions is to be made, the law needs to specify which types of contributions will be refunded first and from which fund.

When drafting the defining rules in this area, Treasury will need to consider a number of variables, some of which are noted here.

- Refunding personal contributions - this may reduce a person's entitlement to claim a tax deduction under section 82AAT or a co-contribution.
- Refunding contributions made on behalf of a spouse - monies must be paid back to the contributor, being the spouse. This could result in lower or nullify any entitlement to a spouse superannuation contributions tax offset. Further complications will arise if the spouse has since passed away or the contributor is now an ex-spouse. If the contributor has passed away and was the spouse of the member on the day they died, Treasury may wish to include a clause to say that the refund will be paid to the surviving member.

ING Life Limited
ABN 33 009 657 176
AFSL 238341
347 Kent Street,
Sydney NSW 2000
Tel: 02 9234 7696
Fax: 02 9234 8936

- Refunding contributions made on behalf of a child - child contributions will be classed as undeducted contributions and any refund may need to be made to the contributor. If the contributor has passed away, Treasury may wish to include a clause to say that the refund will be paid to the contributor where the contributor was alive on the day the ATO made its surplus assessment. In the unlikely event that the contributor passed away on assessment day, the payment could be made to the contributor's estate if the estate is still in administration, otherwise an alternative arrangement needs to be outlined.
- Refunding other types of post-tax contributions (if any). This potential problem was discussed above under subsection 1.7. The recommended amendment to the definition of undeducted contributions will also assist with limiting third party post-tax contributions to “spouse” and “child” only and in turn would make it easier to ascertain the nature of the refund type - that is, a spouse contribution, child contribution or personal contribution.

In our opinion, the only way of policing this area would be to have a co-ordinating body such as the ATO involved. Basically, superannuation fund trustees should be required to report (to the ATO) contribution types and amounts for a particular financial year. In turn, the ATO will then provide instructions on how the refund is to take place. The instructions will include dollar amounts and contribution types that are to be refunded.

ATO participation is necessary because a superannuation fund has no way of knowing which of an exempt component received by way of a roll over or transfer represents a spouse contribution, personal contribution, child contribution or any contribution for that matter. Furthermore, by adopting this monitoring role, the ATO is better able to calculate the taxpayer’s entitlement to a co-contribution or their spouse’s entitlement to a superannuation contributions tax offset.

2. Income streams

2.1 Need to maintain ‘exempt’ and ‘taxable’ components of a pension balance

A pension provider will still be required to maintain the ETP break-up of a pension balance for the following reasons:

- refund of post-tax contributions (exempt component);
- to determine remaining undeducted contributions in the fund for contributions-splitting purposes (exempt component);
- to determine remaining undeducted contributions in the fund for section 82AAT purposes (exempt component);
- to determine the ETP split when death benefits are paid to non-dependants or the deceased member’s estate (exempt and taxable components);
- split of benefits due to marriage breakdown (exempt and taxable components);
- recalculation of ‘notional deductible amount’ pursuant to every commutation (exempt and taxable components).

To simplify operation of the above issues, it is suggested that all pension payments and cash commutations **from age 60** will first reduce the ‘taxable component’ attributable to the pension.

ING Life Limited
ABN 33 009 657 176
AFSL 238341
347 Kent Street,
Sydney NSW 2000
Tel: 02 9234 7696
Fax: 02 9234 8936

2.2 Recalculating deductible amounts for pre-July 2007 income streams

For simplicity it is suggested that income streams commencing prior to pre-July 2007 should be administered according to the same taxation principals as those commencing post-June 2007. This would require a recalculation of deductible amounts as at 1 July 2007.

2.3 Social Security income test arrangements

The absence of a maximum PVF for income streams after 1 July 2007 presents an interesting problem relating to the income testing of income payments from income streams.

If we were to retain the current method for assessing income (actual pension less a non-assessable amount), clients who were to withdraw higher levels of income would potentially be impacted under the income test. To overcome this outcome, clients would be benefited by rolling any desired commutation amount back to the accumulation phase of superannuation and making a withdrawal from there where no amount would be assessable. While this avoidance strategy is can be used to minimise the impact of the current income test, we would expect it to be more prevalent in a post June 2007 environment without RBLs and tax recalculations to hinder its application.

ING proposes a real simplification of the income testing of income streams. We propose that a "concessional deeming rate" be introduced for income streams to encourage clients to receive their superannuation benefits in income stream form. The concessional deeming rate would be set at a level with no regard to the deeming rate applied to financial investments. Instead, the concessional deeming rate would be set at a rate that produces a level of assessable income similar to the level of income currently assessable under the "actual pension payment less non-assessable amount" methodology where a client chooses to draw the minimum pension.

As an example, a 65 year old male client commencing an allocated pension today with $100,000 would have the following pension payments and assessable amounts (assuming a flat account balance):

Age	Min Pension	Non-Assessable	Assessable
65	$ 6,370	$5,650	$ 720
70	$ 7,410	$5,650	$1,760
75	$ 8,850	$5,650	$3,200
80	$10,990	$5,650	$5,340

Applying a concessional deeming rate of 1% or 2% per annum would provide a higher assessable income in the early years of a pension than the current income test methodology and a lower assessable income in later years. The result is simple to administer and simple for clients to understand.

A more complex (but arguably more equitable) variation of this alternative could be to have different concessional deeming rates applying to different age bands of clients. For example, clients less than age 65 have a 1% deeming rate applied, those clients age 65 to 75 have a 2% deeming rate, those 75 to 85 a 3% deeming rate etc. While these rates would approach the standard deeming rates they would always be lower than the standard deeming rates to continue to encourage clients to drawdown their superannuation benefits in income stream form, rather than as a lump sum.

If the standard deeming rates were to significantly move, the concessional deeming rates would require review.

ING Life Limited
ABN 33 009 657 176
AFSL 238341
347 Kent Street,
Sydney NSW 2000
Tel: 02 9234 7696
Fax: 02 9234 8936

3. Employer ETPs

3.1 Concessional limit of $140,000

Excluding CGT retirement exemptions, it has been proposed that amounts received within this $140,000 limit will be taxed more concessionally than amounts above the limit. A number of issues in this area have been noted.

3.1.1 Refreshing the $140,000 limit

It is recommended that a fresh $140,000 limit will apply on a “per termination of employment” basis. This would require monitoring on the part of the ATO.

Other options would be to refresh on a “per financial year” or a “per ETP” basis. These options are less favoured than the “per termination of employment” option for the reason that it would be easy for an individual to split their ETP and receive these over a period of time. For example, an individual could request to have a $280,000 ETP split evenly over two financial years - thereby avoiding the “per financial year” requirement. Another example where an individual would avoid the “per ETP basis” would be if they received multiple ETPs over a period of time, whether it be by agreement with the employer or through the employer not having the funds to complete the payment in one go.

3.1.2 Impact on low rate threshold (LRT)

At present, a post-June 1983 untaxed element will count towards a taxpayer’s LRT if the taxpayer was 55 years of age or older as at the time of payment.

It is recommended that taxable components of employer ETPs do not count towards the LRT, meaning this component is not concurrently counting towards the LRT as well as the concessional $140,000 limit.

3.1.3 Crystallising the pre 1983 amounts

The Government has proposed that the pre-July 1983 component of an ETP is being phased out. For terminations of employment taking place on or after 1 July 2007, it is important that the employer has access to clearly defined procedures when calculating the ‘exempt’ component of an employer ETP. The exempt and taxable components may be calculated as per the formulas below:

Exempt component is the lessor of:

- A + {ETP x (B / B + C)}
- ETP

Taxable component = ETP - exempt component

Where:

A = calculated as per current calculation of a post 1994 invalidity component
B = days in the service period prior to 1 July 1983
C = 8,766 (days from 1 July 1983 to 1 July 2007)

ING Life Limited
ABN 33 009 657 176
AFSL 238341
347 Kent Street,
Sydney NSW 2000
Tel: 02 9234 7696
Fax: 02 9234 8936

3.2 Death benefits

It is recommended that employer ETPs paid following the death of an employee will not be subject to the $140,000 concessional limit. Rather, this payment is best taxed according to death benefit ETP rules.

4. Bankruptcy

4.1 Introducing a new protection limit

Given that the Government has proposed the abolition of RBLs, we believe that it would be appropriate for a substitute limit to be introduced to enjoy a level of protection from creditors. It is preferred if the substitute limit was indexed on an annual basis. The limit could be a 'one size fits all' amount, or alternatively the limit could be adjusted based on the individual's remaining years in the workforce. This means younger individuals would have a lower threshold on the basis they have many more years in the workforce to recoup their lost savings.

4.2 Interaction between taxable components and exempt components

It is preferred that the bankrupt's 'taxable' component in a particular fund be reduced before the 'exempt' component when making payments to creditors under the bankruptcy provisions.

4.3 Interaction with post-tax contributions limit

Any new legislation outlining what counts towards a person's post-tax contributions limit should take into account amounts paid to creditors from the person's superannuation savings.

Also, it is preferred if legislation was in place to indicate how the payment of superannuation amounts paid to creditors would interact with any required refunds of surplus post-tax contributions.

The questions posed in this area have been included in subsection 1.3 above.

5. Other issues

5.1 Over payment of a CGT retirement exemption

The Government has advised that the CGT retirement exemption will not count towards the post-tax contributions cap. This said, there will need to be a process in place where a roll over of a CGT retirement exemption in error (eg. the amount indicated on the ETP rollover statement and paid into the fund was overstated). An example here would be where the taxpayer, subsequent to payment of the CGT retirement exemption into the fund, has realised a capital loss during the CGT-event year.

Our recommendation is to require the taxpayer to notify the superannuation fund that holds the exempt component. The superannuation fund in turn will then refund the ETP amount (less any fees) to the taxpayer. In the event the payer of the CGT retirement exemption is a deceased individual, the refund should be made to the deceased's estate.

ING Life Limited
ABN 33 009 657 176
AFSL 238341
347 Kent Street,
Sydney NSW 2000
Tel: 02 9234 7696
Fax: 02 9234 8936

Additional information

Please do not hesitate to contact Rudy Haddad (by email at rudy.haddad@ing.com.au or by telephone on 02 9234 7164) or Andrew Lowe (by email at andrew.lowe@ing.com.au or by telephone on 02 9234 7939) of ING Technical Services on any of the above mentioned issues for any additional information required.

About ING

ING Australia Limited (ING Australia) is one of Australia's leading fund managers and life insurers with over $30 billion in assets under management and 2,400 staff. ING Australia is a joint venture between the global ING Group, which owns 51%, and one of Australia's major banks, ANZ, which owns 49%.

ING Australia provides a broad range of financial products and services through an extensive network of professional financial advisers and financial institutions, including its own financial advice groups.

ING Group is one of the world's largest wealth managers with more than 60 million customers in over 50 countries. ING Group's global head office is in Amsterdam, The Netherlands, with operational headquarters around the world including Sydney, Australia.

ING Life Limited
ABN 33 009 657 176
AFSL 238341
347 Kent Street,
Sydney NSW 2000
Tel: 02 9234 7696
Fax: 02 9234 8936