A PLAN TO SIMPLIFY AND STREAMLINE SUPERANNUATION

UPDATED COMMENTS

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The Plan to Simplify and Streamline Superannuation categorically states on page 7 that the Plan will not reduce an age pensioner's existing entitlements.

The Plan is however eerily silent on the matter of any changes to the incomes test.

Let's take the case of a 'typical' age pensioner couple with a home and say non financial assets (car, house contents etc) of $25,000, and the rest of their assets being financial assets. When the level of financial assets is approximately $220,000 the effect of the assets test and the incomes test are similar. With assets below this amount the incomes test may reduce the Age pension and for amounts in excess the assets test will kick in.

Under the Plan the taper rate will reduce from $3 to $1.50 for excess assets pursuant to the assets test rules, so the breakeven point where the effects of the income and assets test are equal for our couple of pensioners will rise to $260,000 approximately. But what about the incomes test?

To reduce the effects of the incomes test, the current financial planning strategy is to purchase an allocated pension. One good reason for this is an allocated pension does not attract the deeming rules that usually apply to financial assets under the incomes test. The assessable income under the incomes test for allocated pensions is the amount received, reduced by the purchase price of the pension apportioned over the pensioner's expected life. This amount is invariably less than had the deeming rules applied. Hence the pensioner gets more Age pension.

If the allocated pension is sourced from within the super regime then the added attraction is that the earnings are tax free. The Plan will make all pension income for over 60s exempt from tax. But how will the pension be assessed for income test purposes. The only logical approach is to apply the deeming rules to the pension account balance. But current allocated pensioners may be worse off. They may lose some Age pension.

What about current Age pensioners who have allocated pensions outside the super regime (the so called allocated annuitants)? They too will be worse off if the deeming rules apply, and compared to their colleagues who hold their assets within super and who will receive exempt income, they will be even worse off.

Then there's the question of income tax if a pensioner's income approaches the threshold where tax becomes payable. Will these thresholds change as a result of the Plan? Again the Plan is silent on this question. There a lot of pensioners who receive a mixture of Age pension, a complying pension, perhaps an overseas pension and if they have financial assets outside super, tax may be payable.

And remember when a senior begins to pay tax of 30% it is often accompanied by a withdrawal of the Senior Australian Tax offset(SATO) of 12.5%, a withdrawal of the low income rebate (LIR) of 4% and a shading in of the Medicare levy at the rate of 20%, so effective marginal tax rates can be very high.

To illustrate this take the real life case of a widow with the following income

- Age pension of $8,079
- Interest of $4,340
- UK Dept of Social Security Pension $3,861(net of tax free component)
- UK non contributory pension $6,231
- Less deductions of $75

Her taxable income is therefore $22,436. Tax payable (in 2005) was $1050.The tax free threshold was $20,500. Excess income of $1,936 resulted in a tax bill of $1,050.

So those with non super income and assets are likely to be relatively worse off compared to their brethren whose assets are safely ensconced in super. Will the transitional rules allow them to change to super.? They may be too old to make further contributions to super? And people in receipt of foreign pensions will not receive the 10% rebate that will apply to Australian sourced complying pensions

If someone walks through a financial planner's door with only $200,000 of assets they are often greeted with a touch of ennui, maybe a yawn or two The Plan notes on page 5 the costs for advice re the taxation aspects of accessing super benefits can be between $3,000 an $10,000, so it would be a little hypocritical if any changes resulted in increased payments by pensioners to financial planners and their masters. To make the Plan fairer those affected should be given every encouragement to shift their assets to a super environment where they will be better off. But you can't force everyone into super if there's a Man standing at the door who's going to clip 3% out of the ticket and then introduce you to his colleagues who will probably clip a further 1% to 3% each year. There's got to be another way.

I always believed that Retirement Savings Accounts (RSAs) were a sound idea in theory but in practice the RSA providers made an absolute meal of them. RSAs were designed to be portable super funds for individuals with small account balances, but the miserable returns and the reluctance of the providers to promote them meant they lost their lustre. But I think a similar process could be employed here.

Assume people over 60 could have up to $150,000 invested in let's say Senior Bonds (SBs) then the income would be tax free, in fact tax exempt, thus mirroring the proposed changes in the Plan for super assets. The source of the SBs is irrelevant, whether from a super source or from non super monies. Putting a limit on the amounts is nothing new. The same happens with primary producers under the Farm Management Deposit Scheme (FMDs).

Minimum standards could be drawn up

- SBs would only be available to individual over 60 years.
- SBs to be limited to $150,000 per person.
- All bondholders to be paid at least the deeming rate.

- Keep the administration to a minimum by dispensing with exempt and taxable components.
- No taxable contributions
- All deposits to be simply treated as exempt components
- Report deposits so that data matching will monitor the limit of $150,000.
- Withdrawals to the bondholder to be tax exempt.
- Rollover to super funds to be allowed and maybe even encouraged.
- Only full rollovers to be permitted.
- If the amount of rollover is less than or equal to the original deposit then the amount will be treated as an exempt component by the receiving super fund.
- If an amount is greater than the original amount then the excess is a taxable amount

The Government could administer the Senior Bonds in the same way as FMDs, They could be provided by banks, industry super funds, wealth management companies etc.

The current rules since 1st July 2004 have allowed persons not in eligible employment (ie full time investors) to claim a tax deduction for contributions to a super fund provided they're under 65. The proposed rules as I understand them, will allow undeducted contributions until the age of 75. This still leaves those older being disadvantaged.

But also those with all their assets outside the super regime need a little bit of encouragement and support to enable them to easily transfer their assets to a more favourable environment.

At worst the arrangements could be transitional, for say 5 years. This may be enough time for older persons to rearrange their affairs and for those in or approaching retirement, having ruled out a post retirement super option, to rearrange their plans.

Then there's the issue of persons with foreign pensions. Why don't these people get a 10% tax offset on their pension, the same as for those with Australian pensions from an untaxed source?

If the plan is to simplify and streamline why not go a step further and scrap the senior tax offset (SATO) and low income rebate LIR) for persons over 60 years of age and replace them with a 10% rebate that applies not only to pensions from a local untaxed source but also to foreign pensions and Centrelink pensions.

Employed persons over 60 are already catered for with the Mature Age Worker's Tax Offset of 5% up to a maximum of $500. This could be adjusted to give them equity compared to their retired colleagues.

In the case of the widow in the example above her taxable income would reduce to $18,096 if the interest income of $4,340 was exempt because it came from tax exempt Senior Bonds. And her rebateable pension income would be $18,172 which would provide a tax offset of 10% or $1,817.

The resultant tax payable will be nil, which would certainly be the case if the pensions were all locally sourced and the interest income replaced with tax exempt pension withdrawals.

Also another small point in passing, I've noticed in discussions with clients that the provisions that allow for the CGT exempt component which applies to post 1985 assets, (and which when rolled to super is not included in the proposed limits on undeducted contributions) should be extended to cover pre 1985 assets. It's fairly easy to argue on equity grounds that pre 1985 assets be treated at least equally as post 1985 assets. Otherwise it would be the first instance I can recall where grandfathered assets were disadvantaged.

The Plan is an excellent attempt to simplify and streamline superannuation, but has concentrated more on higher income earners. Sure, that's where the majority of the money is, but it's not where the majority of the people are. The Plan is silent on the application of the incomes test. It needs to address the inequities that may result from having non super assets versus super assets and it needs to provide some transitional arrangements to further simplify and streamline the system.

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Dear Sirs et al

The Plan to Simplify and Streamline Superannuation took a U turn with the release of the work test rule for people age 65 and above on the Fact Sheet titled 'Post-tax Contributions'

Writing from the viewpoint from one involved in the audit and advice area for SMSFs, I was amazed to read that the proposed averaging provisions may require a yearly review of the work test for persons 65 and over to decide whether to retrospectively allow a Fund to accept an undeducted contribution.

I cannot recall a similar provision in the Tax Act.

What happens if

- The person gets sick and can't work as planned? Will some of the undeducted contributions need to be refunded and the top marginal tax rate applied to earnings?
- The person dies before the expiry of the 3 year averaging period?
- The person withdraws all superannuation and gifts it all?

- The person rolls the superannuation benefit to another Fund? Will the receiving Fund be required to seek details of undeducted contributions over the previous 2 years?

Surely in the interests of an administratively simpler system, the contribution needs to be assessed once and for all at the time the contribution is made. And to do this, you need to replace your proposed averaging system with a rolling 3 year average, with the final triennium ending no later than the year in which the person turns 75. The rolling average will be somewhat similar to the primary production averaging provisions in S.392 of the 1997 Tax Act.

Trustees and auditors will be able to monitor most contributions but if an excess contribution remained undetected, it would be picked up by the ATO when the Fund MCS statements were lodged.

Surely there's got to be a little more horizontal equity between working persons regardless of age. A person who retires at 63 can make an undeducted contribution of $450,000 whereas a person of 66 about to retire may only be able to make a contribution of $150,000. Doesn't seem fair to me.

You may recall that when 10 hours work in any one week was sufficient to justify an undeducted contribution, financial planners quite openly arranged sham employment arrangements for older persons in order to get money into the superannuation environment. Babysitting grandchildren was enough wasn't it? I can imagine the same occurring again if the system is perceived as inequitable

For persons who have contributed more than $450,000 since 9th May 2006 (and there wouldn't be many) the excess could be a further exemption to the cap.

Yours sincerely

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