

## **Assessment of the proposal**

These comments are made by Superannuation Australia, a fully owned subsidiary of Taxpayers Australia, 1405 Burke Road, East Kew Victoria 3102, Phone (03)88514555. They are in response to the government's call for comments on its proposal to simplify and streamline superannuation.

### **Simplification**

This proposal makes a serious effort to simplify super and give ordinary members of the community a chance to better understand it and hopefully engage with it. The obvious attraction of tax free income for both pensions and lump sum payments from taxed super funds to those who have reached 60 and the elimination of reasonable benefit limits (RBLs) provide good grounds for believing that the community could become motivated to give much more attention to retirement savings through super. If the truth be known any disengagement with super will be detrimental since the new regime requires an ongoing focus and commitment to contributions; resulting from the introduction of contribution caps and a lowering of the age based limit in the long term for those 50 and over. The latter demographic has traditionally been better able to make significant super contributions so a new approach will be necessary. Contribution limits are a key pillar of the proposal, replacing the existing RBLs that limit the extent of concessional benefits received by individuals.

### **Complexity remains**

These changes have the potential to simplify super particularly for those 60 and over but the system retains many complexities for others and quite obviously transitional issues arise due in part to the radical change that is proposed. It may not be easily measured but strategies based on large future super contributions and very little short term savings in super are drastically affected by the new proposal. Since saving for retirement is a long term strategy there are many who are part way through a strategy that will be adversely affected by this change.

### **Problems for over 50s**

In the medium term the government appears to have partly catered for this with the transitional arrangements for deductible contributions but the inherent problem of limiting the over 50s age group to making smaller contributions in the future is problematic. The proposed transitional limit that applies is comparable to the current ABL however after 2011/12 it will be halved.

### **Caps at contribution or benefit end?**

It is a moot point whether the approach of eliminating RBLs and introducing contribution limits is preferred to the retention and streamlining of the existing system that has admittedly had significant RBL management problems. Purists might argue that controls are better placed at the payment or benefit end of the system. However we are attracted by the operational simplicity that appears to come with this proposal and this could override the advantages of controls applied at the benefit stage.

### **No arbitrary saving levels**

The removal of any de facto reasonable level of retirement savings that individuals could aim towards, namely the RBL limit has by inference left open the door for savers to maximise their retirement accounts. This perhaps also aims to wean future

retirees off Centrelink benefits while forcing greater attention to super throughout the taxpayer's full working life.

### **Existing pensions (asset test concessions)**

The grandfathering of all existing pensions that were commenced prior to the new system will retain their existing assets test concessions for purposes of Centrelink benefits; this includes the 100% and 50% assets test exempt pensions. While this is preferable to stripping them of these characteristics, the elimination of all asset test exemption for new pensions is detrimental to those who have relatively small to medium sized accounts who are likely to be trapped into receiving a relatively small Centrelink benefit if at all.

### **Assets test impact**

For those in the fortunate position of having significant super savings in excess of the current RBLs, the new proposal provides windfall gains that would previously have been taxed. On the other hand, unfortunately those at the lower end of the scale are faced with the removal of the 50% assets test concessions for new complying pensions. This is a major blow and instead of targeting these individuals for better support, their position is weakened and unfortunately this will become entrenched as we are unlikely to see the reintroduction of assets test exemptions for super pension assets.

### **Assets test taper**

The assets test taper on the other hand has been widely trumpeted as providing greater access to Centrelink benefits. Retirees with top-up strategies aimed at achieving something less than full Centrelink benefits would appear to benefit. However, overall this may be inadequate compensation for the removal of the 50% assets test concessions. Individual circumstances will ultimately determine exactly who wins and who loses in this change in the way that benefits are assessed including existing complying pensions.

### **New pension standard**

The proposed new standard for pension payments requiring a minimum drawdown somewhat less than the current minimum from existing pension standards is clearly an improvement. But there will be significant discontinuities in the drawdown pattern based on a minimum drawdown over a typical retirement term. The ability to fully draw down the assets supporting the pension provides much needed flexibility and is a welcome improvement to the pension standard.

The new concept of allowing super funds to be held indefinitely in the accumulation phase is also a refreshing change and one to be commended. Clearly individuals can choose to commence pensions and also receive the benefits of a 0% tax on earnings of the fund. Alternatively they could retain the fund in accumulation mode for an indefinite period with a tax of 15% on its earnings. The opportunity to make a choice on this matter will be of great benefit to many.

### **Impact of tax free income**

Some commentators and professionals have decried the freedom and flexibility that will be available for retirees to make lump sum withdrawals. Their concern stems from a view that the system is exposed to double dipping by those who would

subsequently access the social security system. We do not support that thesis as the main anecdotal evidence from our members suggests quite the opposite. People seem to be much more concerned with a desire to protect their capital in retirement and go to some lengths to try and achieve this. We believe that giving citizens a chance to try and take charge of their retirement funding is preferable to a nanny state approach of second guessing the individual's needs and preferences.

### **Undeducted contributions**

Prior to May 2006 there were no limits on the amount of undeducted contribution made to super. However there has always been the perception that pensions sourced with taxed funds within the relevant RBL amount would yield fully rebatable pensions. But if large additional undeducted contributions were used to commence further pensions, technically these would also be fully rebatable irrespective of the amount of the pension. There is clearly a flaw in the current rules that needs to be fixed. The proposed new system will treat all benefits to the member equally.

The introduction of a \$150,000 UDC limit from the time of the budget announcement is problematic since previously no such limit existed. In relation to the ABL this is very significant because it is not uncommon for UDCs comparable to the Pension RBL or greater to be made to super before retirement.

A critical factor is that this is the age group when taxpayers' incomes are likely to be at their highest and personal and family commitments ease off. The design of a system that limits the ability to make contributions to super should also consider the level of retirement savings that the individual has before the proposed limit cuts in. It is during this period that retirement plans involving the sale of investments to fund future retirement incomes are increasingly likely. A sudden curtailment of this ability to make larger single UDCs is very serious and discriminates unfairly.

For those who have not had significant super cover in the past or not been able to contribute more than the SG rate (SG is a relatively recent innovation) during their earlier working life will face serious problems. They comprise a significant proportion of the workforce in their 50s, including women or others who are returning to the workforce. They may have only recently been able to make significant super contributions and would be severely disadvantaged by the caps placed on contributions, including deductible ones.

The UDC limit is potentially a huge problem for those saving outside super. These savers will now be required to save within super in the future. A necessary precondition for the Treasurer's proposal to work properly is for the government to be accommodating for transitional and other issues, which are outlined below.

### **Transitional Issues**

A number of issues that were addressed in the period immediately after the budget announcement have provided some sorely needed guidance though some need to be revisited.

The fact that the changes proposed are so radical that it is extremely difficult for those say who are near age 65 to re-align their affairs in a manner best suited to the proposed super system. The age based work test unfairly discriminates against this

group. They will be unable to use the averaging rules if they have ceased working. At the very least transitional rules should put aside work based eligibility rules for those 65 and over until 2011/12.

Our preference is to put aside this discriminatory eligibility criterion all together.

The current \$450,000 limit may still be too limiting for those who will not have the benefit of a number of decades of contributions to super. Another view would be a modification to the proposal that would allow for uncapped contributions up to the current Lump sum RBL or say the small business CGT exempt amount of \$500,000. Once this is reached the proposed annual \$50,000 deductible and \$150,000 could apply. Something that provides some assistance for the over 65s is necessary.

### **Deductible cap**

Clarification is necessary in relation to when a person reaches 50, for the \$100,000 deductible contribution limit to apply. We interpret it to mean that the higher amount of \$100k will apply from the year that the person reaches 50 provided that this occurs by 2011/12.

(It does not suggest that eligibility is limited to those 50 and over on 1 July 2007?)

### **Indexation**

This may raise some minor complexity but is essentially recommended on equity grounds. The key contribution limits (\$50k, \$100k and \$150k) should be indexed.

### **Splitting**

If a member splits to a spouse this is counted towards the member's annual contribution caps. This seems to be draconian. There is no recognition that the amount leaves the member's account.

New arrangements should allow for the sharing of a member's account with a spouse at time of retirement. The current splitting rules allow this to happen to current contributions. Could it not be allowed for past contributions to allow for a re-balancing of funds between member and spouse?

### **Pensions**

1) A clarification of the treatment of tax free income from super for those 60 and over is necessary. We understand that the intention is to treat it as non-assessable and non-exempt income. In other words it will not appear anywhere on tax returns and will not impact the tax rate of other income. Could this please be clarified?

2) What is the status of existing pensions paid from "excessive amounts" ie those that are currently not rebatable? Do these become fully rebatable (at 15%) for those under 60 from 1 July 2007?

3) This is an opportunity to simplify the CGT rules surrounding the issue of those assets that are not sold prior to the pensioner's death to enable them to have a cost base for CGT that commences on the date of death or within some time thereafter. (SMSF trustees often manage the CGT liability by selling and usually buying back those assets in the fund during the pension phase to obtain a current cost base. This is an unnecessary additional chore that is best be done away with.)

4) Payments made from super funds should be in cash or in specie. Since the entire amount can be cashed out there is little point in requiring this to be cash only payments. It adds to the expenses of those SMSF beneficiaries who prefer to receive certain benefits in specie (eg ASX listed assets or property).

5) The drawdown tables for allocated pensions should be altered to reflect the drawdown factors for the new pension. So that from July 2007 the new factors would apply to all allocated pensions. All market linked and other complying pensions should be able to be rolled into the “new pension”.

The migration of existing allocated pensions to the new universal pension will occur because of the commutability of allocated pensions. It would be much easier if this becomes the new standard for allocated pensions obviating the need to formally roll over existing balances into the new standard pension.

All current pensions (allocated, market linked and defined benefit complying pensions) fall within the drawdown envelope of the new pension standard. However the new pension provides additional flexibility because the minimum annual amount is slightly less than the minimum amount available from current pensions and a full draw down is also possible under the new standard.

A rollover of all existing life/life expectancy pensions from taxed funds into the new pension should be permitted for those who seek to do so. Those who prefer to retain their existing pensions because of assets test advantages should be able to maintain those pensions for a period of their choosing and then roll them into the new pension if desired. If a complying pension was accessed in order to receive the benefits of the pension RBL why should it now be penalised if the rules are liberalised with the elimination of the RBLs?

Options for pensions paid from untaxed sources should also be provided with similar flexibility after requisite taxes are paid.

6) Would a roll over of existing MLPs with 50% assets test exemption imply the commencement of a new pension in the new regime and therefore a loss of existing assets test concessions?

7) For those who are able to contribute to super while already drawing down a pension there is a need to be able to merge the newly contributed funds with the existing assets supporting the pension. This is particularly important for situations where relatively smaller “accumulation” accounts arise. The “new” assets should either be added to the pension assets at the time of contribution (net of contribution tax if applicable) or this could be done at the end of the financial year so that it could be part of the new account balance for purposes of determining the new annual payment.

This is important to prevent the build up of separate accumulation accounts that the beneficiary won't access because any further savings would otherwise create another accumulation phase etc making the whole process very cumbersome. This simplification would cut through much red tape.

8) Consider a super fund paying a reversionary MLP; it is 50% assets test exempt. If the primary pensioner dies, the reversionary pensioner continues to receive the 50% assets test exemption. What happens if this pensioner names a reversionary beneficiary to their pension, will the 50% assets test exemption for the second reversion continue?

### **Scrap age controls on contribution**

The post 65 work test eligibility criterion for contributions to super is discriminatory and should be scrapped.

### **Controls**

1) Concessions are provided for superannuation savings because as a community we seek to encourage people to save for their retirement in super. It therefore seems entirely illogical to have caps and age based limits that prevent contributions from being made to super not because there are excess funds in the account but because an individual has reached a certain age but have no super savings to speak of! We should not ignore the idea of assessing the size of the super account before we slam the door shut on contributions (eg caps and age based employment conditions etc)

2) Drop the *use it or lose it* approach to UDC and allow individuals to accumulate this up to say \$1million. This will overcome the current problem in relation to UDC caps and the issue of dealing fairly with those who have low super account balances.

3) Modify related party investment prohibitions to enable residential property to be contributed as post tax contributions or deductible contributions within the current caps to SMSFs.

4) The proposed annual control limits of \$150,000 UDC should not require a work test for those who have reached 65.

5) There is a need to highlight to the community a requirement to make available their tax file numbers to their fund as a failure to do so will be penalised by having concessional contributions taxed at the top marginal tax rate while post tax contributions will not be accepted.

6) Generally those who had taken action prior to the announcement should be given some opportunity to reverse those actions so as to benefit in line with the proposed new changes.

But specifically those who commenced transactions in relation to the previous rules and were in the process of sale of assets or cashing of ETPs and or rebalancing of spouse/member account balances at 9 May 2006 should be able to reverse this if necessary.

### **Over 65s**

As mentioned previously, eliminate the work test eligibility criterion for those 65 and over to contribute to super

Or

Transitional issue, eliminate this until 2011/12 for all. This allows for those who have laboured under the existing rules to be able to readjust in line with the new regime.

After that allow at least half the proposed contribution caps for those over 65 and not working for both concessional and post tax contributions.

**Death benefit**

The issue of the fund composition based on exempt and taxed elements is not relevant for current members and dependants but it is for non-dependants.

It seems that the greater the level of exempt components in the fund the greater the tax efficiency of paying non-dependants.

Please clarify the rules for death benefit payments to non-dependants?

**Disabled**

Super payments to disabled should be tax free as per post 60 age super payments.

**Final Comment**

With a sympathetic hearing aimed at a satisfactory resolution of the above issues the government's new proposal will cut through red tape, free up super, provide greater fairness and encourage a large degree of super self-reliance for more Australians.