

# **A Submission in response to the Treasury proposal “A Plan to Simplify and Streamline Superannuation - May 2006”**

## **Summary of Recommendations**

### **1. The Concessional \$700,000 Lump Sum and Rollover Limits**

**Recommendation:** Consistent with the treatment of taxed benefits, the method of calculating the concessional \$700,000 lump sum and rollover limits from untaxed schemes be re-examined to ensure that only this represent prospective benefits and includes only future contributions.

### **2. Indexation of Superannuation Limits & Thresholds**

**Recommendation:** All superannuation tax limits and thresholds be indexed by AWOTE.

### **3. Post Retirement Income**

**Recommendation:** The proposal to pay the 10% income tax offset to pensioners of untaxed schemes be re-examined to establish a method of ensuring that these pensioners do not experience a discriminatory income tax regime in relation to any post retirement income

### **4. Portability**

**Recommendation:** The 90 day portability rule be retained for defined benefit schemes.

### **5. Lost Members Register**

**Recommendation:** Defined benefit schemes be extensively consulted on any proposal for implementing a standardised approach to lost member accounts.

### **6. Pensions paid to a spouse on the death of member or pensioner**

**Recommendation:** The 10% tax offset be paid to all reversionary pensions paid from an untaxed source, regardless of the age of the recipient.

### **7. Invalidity Superannuation Pensions**

**Recommendation:** The 10% tax offset for pensions paid from an untaxed source from age 60 be applied to invalidity pensions paid from an untaxed source without regard to the age of the invalidity pensioner.

**8. Medicare Levy**

**Recommendation: Pensioners from untaxed schemes aged 60 or over not be required to pay the Medicare Levy on the income from their pensions.**

**9. Superannuation Surcharge Tax**

**Recommendation: A mechanism be established to properly account for the Superannuation Surcharge Tax paid by contributors in defined benefit schemes (on their notional employer superannuation contributions) with a commensurate reduction in their taxation liabilities upon retirement.**

**10. Surcharge debts for members of defined benefit funds**

**Recommendation: A mechanism for the early payment of the accumulated surcharge tax debt of defined benefit scheme contributors be included in this proposal.**

**11. Maximum Benefit Limit in the Public Sector Superannuation Scheme**

**Recommendation: The PSS be re-examined to ensure that the Maximum Benefit Limits reflect the proposed superannuation benefit limits.**

## Issues and Recommendations

### 1. The Concessional \$700,000 Lump Sum and Rollover Limits

This proposal treats lump sums from an untaxed scheme both retrospectively and prospectively, that is both existing and future contributions count towards the \$700,000 untaxed benefit limit. The arrangement for taxed schemes disregards existing contributions and only limits the concessional treatment of future contributions; consequently, members of untaxed schemes seem to be at a comparative disadvantage.

The \$700,000 untaxed benefit limit should be prospective only to ensure equality of treatment between members of taxed and untaxed schemes. This would require that existing untaxed benefits be calculated and these contributions be then accounted for separately from prospective benefits. Future contributions would then be counted as part of the prospective benefits. An alternative approach would be to significantly increase \$700,000 untaxed benefit limit, probably to an amount in excess of \$1 million.

**Recommendation: Consistent with the treatment of taxed benefits, the method of calculating the concessional \$700,000 lump sum and rollover limits from untaxed schemes be re-examined to ensure that only this represent prospective benefits and includes only future contributions.**

### 2. Indexation of Superannuation Limits & Thresholds

Consistent with existing practice on superannuation limits and thresholds, the indexing of all limits in this proposal by AWOTE needs to be included to ensure the maintenance of the real value of individual member benefits.

**Recommendation: All superannuation tax limits and thresholds be indexed by AWOTE.**

### 3. Post Retirement Income

The proposed 10% income tax offset is a benefit for pensioners from untaxed schemes such as the CSS and PSS. Nevertheless, where these pensioners have additional income they are at a comparative disadvantage to a pensioner from a taxed scheme. For example where there is post retirement income from a part-time job or from investments, earning \$6000, the pensioner from a taxed scheme will pay no income tax and will have the full benefit of this income.

A pensioner from an untaxed scheme, even after the 10% tax offset, will be required to pay income tax on their pension. Where a pensioner has post retirement income from a part-time job, they will be required to pay income tax at their marginal rate in relation to any additional income. Using the \$6000 example above, a typical CSS or PSS pensioner can expect to only keep

about \$4200 of this income. Clearly, this is a significant inequity between pensioners from taxed and untaxed schemes and appears to be an unintended consequence of the current proposals.

**Recommendation: The proposal to pay the 10% income tax offset to pensioners of untaxed schemes be re-examined to establish a method of ensuring that these pensioners do not experience a discriminatory income tax regime in relation to any post retirement income**

#### **4. Portability**

Defined benefit funds such as the CSS and PSS are by their nature complex entities, particularly where there are multiple memberships or contribution periods. When this is combined with the necessity to obtain information from a variety of sources, including third parties and the need to calculate complex benefits rules it is clear that a 30 day portability period is impractical for these funds and is likely to lead to errors and omissions. While a minimal portability period is desirable for all contributors, there seems little point in imposing a portability period which is clearly insufficient to ensure that the benefits being transferred are correct and that the rights and entitlements of individual contributor to defined benefit schemes are protected. This proposal will not assist defined benefit fund members including contributors to the PSS and CSS.

**Recommendation: The 90 day portability rule be retained for defined benefit schemes.**

#### **5. Lost Members Register**

The standardised approach to consolidating lost member accounts may not be practical with defined benefit schemes such as the PSS and CSS. There are a variety of benefit options available to contributors exiting the PSS and CSS and this is the case for most other defined benefit schemes. While the proposal seems to be designed to deal effectively with the relatively straightforward issue of consolidating accumulation accounts, it is unlikely that such a standardised process will be able to deal with the complexity of defined benefit funds. The ATO will be required to understand and administer a variety of benefit options from a large number of defined benefit schemes. This may lead to individual contributors, when located, being denied access to the full range of benefit options available in their particular scheme. Clearly, the current proposal is unlikely to advantage individual contributors from these schemes.

**Recommendation: Defined benefit schemes be extensively consulted on any proposal for implementing a standardised approach to lost member accounts.**

## **6. Pensions paid to a spouse on the death of member or pensioner**

The CPSU supports the SCOA position on pensions paid to a spouse on the death of member or pensioner and believes that this should also apply to the payment of an orphan's pension:

“The spouse of a CSS member or pensioner or a PSS pensioner does not have the option to take a lump sum and if they are under age 60 they are forced to take a pension taxed at marginal tax rates. SCOA considers that to be equitable with death benefit lump sums paid to dependants, reversionary pensions paid to dependants under age 60, where the primary beneficiary was also under age 60, should be subject to the same rules applying to superannuation pensions paid to those aged 60 and over. With regard to reversionary pensions paid from an untaxed source this would mean that the pension would be subject to at least a 10% tax offset.”

**Recommendation: The 10% tax offset be paid to all reversionary pensions paid from an untaxed source, regardless of the age of the recipient.**

## **7. Invalidity Superannuation Pensions**

There is nothing in these proposals to provide any assistance to retirees receiving an invalidity pension from an untaxed scheme such as the CSS and PSS. Generally, these pensions are taxed at the member's marginal tax rate (although there may be some reduction in their personal income tax if part of the pension is also sourced from their undeducted contributions).

A person who retires due to invalidity and receives a lump sum is entitled to a concessional component which reflects their prospective employment to normal retirement age (this is the post-June 1994 invalidity component) and this component becomes part of their undeducted contributions. This part of the lump sum is free of tax whether from a taxed or untaxed source. If the lump sum is used to purchase a pension, there is a reduction in income tax from the pension to reflect this tax free component.

Recipients of an invalidity pension paid directly from an untaxed scheme are the subject of inequitable treatment in comparison to an invalidity retiree who receives their benefit as a lump sum and then rolls this over to purchase a pension. A similar tax concession as is available to pensioners of untaxed schemes at age 60 would appropriately address this inequity.

**Recommendation: The 10% tax offset for pensions paid from an untaxed source from age 60 be applied to invalidity pensions paid from an untaxed source without regard to the age of the invalidity pensioner.**

## **8. Medicare Levy**

The Treasury proposal that superannuants from taxed schemes not pay income tax on their pensions also means that these retirees will not be required to pay the Medicare Levy. Pensioners from untaxed schemes such as the CSS and PSS will be required to continue to pay income tax on their pension (even with a 10% income tax offset) and as a consequence they will also continue to be required to pay the Medicare Levy. This is a clear inequity in the treatment of pensioners from taxed and untaxed schemes.

**Recommendation: Pensioners from untaxed schemes aged 60 or over not be required to pay the Medicare Levy on the income from their pensions.**

## **9. Superannuation Surcharge Tax**

High income earners of unfunded superannuation schemes such as the CSS and PSS were required, between August 1996 and June 2005, to pay the Superannuation Surcharge Tax on the notional employer superannuation contributions to these schemes. The Treasury proposal does not appear to have taken account of the fact that this is an instance of tax being paid in what is otherwise an untaxed scheme. As these contributors have been required to pay tax, this part of their superannuation scheme is no longer “untaxed”; however, they do not appear to receive any offsetting benefit upon retirement.

**Recommendation: A mechanism be established to properly account for the Superannuation Surcharge Tax paid by contributors in defined benefit schemes (on their notional employer superannuation contributions) with a commensurate reduction in their taxation liabilities upon retirement.**

## **10. Surcharge debts for members of defined benefit funds**

High income earners of superannuation schemes such as the CSS and PSS were required, between August 1996 and June 2005, to pay the Superannuation Surcharge Tax on the notional employer superannuation contributions to these schemes. In defined benefit schemes such as the CSS and PSS, payment of the surcharge tax is made only when a benefit is paid from the fund. Consequently, in the CSS and PSS accounts have been established for these debts which continue to accrue compound interest at the 10 year bond rate.

These outstanding surcharge liabilities will continue to increase in size until superannuation benefits are paid on retirement. For younger contributors, the interest on this debt may well exceed the actual surcharge tax debt. Accumulation schemes were required to pay the surcharge tax assessments as these were issued by the ATO each year.

While the outstanding surcharge debt can be paid at any time from after-tax earnings, this significantly increases the cost of paying the surcharge tax,

particularly in comparison to payments from accumulation schemes. The current arrangements have acted to discourage the payment of these debts which now seem likely to be around for many years.

As has been suggested by Daryl Dixon (Canberra Times, 1/8/06);

“Two simple changes could be implemented along with the budget changes. The first would be to allow CSS, PSS and other similarly affected fund members to ask the ATO to send their outstanding surcharge liabilities to another super fund, e.g., their salary- sacrifice fund, for payment. Having the liability paid by a super fund is the option available to accumulation-fund members. The second method would be to offer a discount of between 25 and 30 per cent for payment from after-tax incomes. This is the model used to encourage early payment of HECS liabilities.”

**Recommendation: A mechanism for the early payment of the accumulated surcharge tax debt of defined benefit scheme contributors be included in this proposal.**

#### **11. Maximum Benefit Limit in the Public Sector Superannuation Scheme**

One objective of this proposal is to abolish the Reasonable Benefit Limits (RBLs), replacing these with a quite generous maximum annual contribution of limit of \$50,000 taxed at the 15% concessional rate (with even more generous transitional contribution limits) and an annual limit of \$150,000 of undeducted contributions. Members of accumulation schemes now have the opportunity to build-up a taxed superannuation benefit significantly in excess of the limits imposed by the current RBLs and then use their lump sum to purchase a concessional tax pension.

The Maximum Benefit Limit (MBL) in the PSS is an integral part of the scheme and has been set at 8 times the final average salary (it is somewhat higher for low income and lower for high income members). As part of the development of the PSS the MBL was derived from the (RBLs). By making the maximum contributions of 10% of superannuation salary, most PSS members can achieve the MBL in 29 years of contributory service. The standard contribution of 5% will achieve the MBL in 38 years.

With age 60 retirement being promoted as the community standard, there is considerable scope for a PSS contributor to achieve a MBL and then continue in Commonwealth employment without having the opportunity, now afforded to other workers, to use the proposed superannuation arrangements to maximise their retirement benefits. Clearly, the PSS has been constructed on the basis of a set of benefit limits that the Government has decided to abolish and in these circumstances, this aspect of the PSS needs to be re-examined.

**Recommendation: The PSS be re-examined to ensure that the Maximum Benefit Limits reflect the proposed superannuation benefit limits.**