

6 August 2006

General Manager
Superannuation, Retirement and Savings Division
The Treasury
Langton Crescent
Parkes ACT 2600

Dear Sir or Madam,

Re: A Plan to Simplify and Streamline Superannuation

I am writing in respect of the above (which, in this letter, I will refer to as “the Document”) published in May 2006 following the last Federal Budget.

For the purposes of this letter, I will be assuming that the measures will be introduced as announced. Accordingly, unless there is a specific reference to the contrary, it will be assumed that pensions and lump sums referred to in this letter will be paid on or after 1 July 2007 to a person who is over 60 years of age. Also, again unless stated otherwise, a reference to a “pension” is a reference to a pension paid out of, or by, a superannuation fund, while a pension paid by Centrelink is referred to as an “age pension”.

This letter, which is a submission in relation to the Document’s proposals, is based on the perspective of a Federal public servant who is a member of ComSuper, in particular, the Commonwealth Superannuation Scheme (the CSS), but the comments below would appear to apply, to some extent, to other pensions and benefits paid out of all “untaxed” superannuation funds.

In general, I support the proposals outlined in the Document. There are, however, two things that I consider should be addressed.

The first relates to the definition of an “untaxed superannuation fund”. The second relates to the relativities between the income tax payable by recipients of pensions from taxed funds relative to the income tax potentially payable by those in receipt of a pension from an untaxed fund.

1. Definition of “untaxed superannuation fund”

I understand that the Document is only a summary designed to give information for the purposes of allowing discussion to take place, and submissions to be made, in relation to the proposals that are intended to be made to the taxation provisions relating to superannuation and superannuation pensions. As a result, the comments under this heading may not be necessary. However I would like to take this opportunity to address the definition of an “untaxed superannuation fund” in the interests of completeness.

From my reading of the Document, it would appear that the definition of an “untaxed superannuation fund” needs to be worded in such a way as to achieve the result that I understand is the intention of the proposed provisions.

As a member of the CSS, I am required to contribute at least 5% of my income to the fund. This contribution is on an “after tax” basis, for which a tax deduction or rebate is not available to me. From a strict reading of the wording in the document, when I retire and draw out my lump sum, it will appear, *prima facie*, that the lump sum or pension would be coming from an “untaxed superannuation fund”. This would mean that the amount that I will receive will not be entirely free from tax (whether before turning 60 or after turning 60) except for any pre-1983 component, even though there have been no deductions claimed in respect of any of the contributions. On the other hand, those who salary sacrificed into superannuation, therefore paid far less tax in respect of the amounts involved, will, once they turn 60 years of age, be able to draw a lump sum or pension entirely free from tax.

I understand that, under the proposals as contained in the Document, a lump sum made up of a member’s contributions plus “interest” paid out of an untaxed superannuation fund is intended to be free from tax when paid to someone who has reached the age of 60, but the wording of the current proposal does not appear to convey that intention.

By implication, again based on the current definition of an untaxed superannuation fund, it would also appear that any pension paid out of this lump sum will not be exempt from tax, even though the intention would appear to be that such pensions would be free from tax in the same way as pensions paid out of taxed funds.

Unless this definition is put into terms sufficient to give effect to the proposal as intended, pensions which, due to the application of the “undeducted purchase price” provisions, are largely free from income tax now could become taxable.

2. Rebate on pensions from “untaxed superannuation funds”.

The next matter relates to the rate of taxation to be applied to pensions paid out of untaxed superannuation funds.

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The principles on which the proposed treatment of pensions, for taxation purposes, as contained in the Document, are based are sound. However, it is submitted that some consideration is needed to making some modification to the proposals to ensure that the aims of the provisions are given proper effect.

A pension paid out of a taxed superannuation fund is, under the proposals contained in the Document, free from income tax on the basis that contributions to the superannuation fund and the income of the fund had borne tax at 15%. On the other hand, as the pensions paid out of untaxed superannuation funds have not been subject to tax on either contributions or income (in this context, the reference is to the amount contributed by, or paid out of, Consolidated Revenue, not the amount contributed by the member as referred to earlier in this letter), such pensions will be subject to tax at marginal rates but subject to a rebate of 10% on the basis that this will give parity between the two types of pensions.

With respect, I do not think that the proposal, as currently enunciated in the Document, will achieve the anticipated parity except in a small number of instances.

The “problem” arises mainly when a pensioner derives additional income (whether from investments or as a result of returning to, or continuing in employment).

A person who is in receipt of a pension from an untaxed superannuation fund and who derives some other income could be required to pay more income tax (even after taking into account the rebate) than someone who is receiving a far larger pension from a taxed fund and also receives the same amount of “additional” income as the member of the untaxed superannuation fund.

For example, the person who is receiving a pension of, say, \$30,000 from the untaxed superannuation fund and has additional income, may have a marginal tax rate of 31.5% (including the Medicare levy) on that income, resulting in tax payable, before the 10% rebate, of \$9,450. The rebate of 10% (that is, \$3,000 in this example) will reduce this liability to \$6,450. This is a taxation rate of 21.5% and is higher than the 15% that would be required to ensure that there is parity between the two types of pension as stated in the Document as being the basis used to arrive at the 10% rebate¹.

A possible solution that could be applied to incomes paid out of untaxed superannuation funds is to impose a top marginal rate of 15% on the pension paid out of the untaxed fund.

This proposal could be achieved by first calculating the income tax payable on the non-pension income (this will result in exactly the same tax consequence for all in receipt of the same amount of non-pension income).

¹ Incidentally, this does not take into account the fact that the person who receives the pension from a taxed superannuation fund was probably able to reduce the total tax payable from their personal marginal tax rate of 48.5% to 15%, which is the rate of tax payable by superannuation funds on taxable contributions received.

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The pension from the untaxed superannuation fund is then added.

If the resultant rate of tax on the pension is less than 15%, there are two possible scenarios. The first is that the 10% rebate be given (as proposed in the Document) or no additional rebate is given. This is a decision for Government, but my suggestion is that the principles as contained in the Document, whereby the 10% minimum (but non-refundable) rebate is given.

On the other hand, if the resultant rate of tax on the pension is greater than 15%, a rebate sufficient to reduce the tax to 15% can then be given. This rebate could vary from 1.5% (the equivalent of the Medicare levy) to 16.5% (there would be very few, given the new tax rates, who would require the higher rebate of 31.5%, but this could be considered).

It is only in this way that there could be true equivalence between the two types of superannuation pensions in order to give effect to the intent of the Document.

For example, Person A receives a pension of \$30,000 from a taxed superannuation fund and Person B receives the same amount of pension from an untaxed superannuation fund. Both Person A and Person B have additional, non-pension, income of a further \$30,000. Their respective tax position under the current proposal as contained in the Document would be as follows:

	Person A (pension from taxed fund)	Person B (pension from untaxed fund)
Non-pension income	\$30,000.00	\$30,000.00
Pension income	\$30,000.00	\$30,000.00
Total income	\$60,000.00	\$60,000.00
Taxable income	\$30,000.00	\$60,000.00
Tax payable (including Medicare levy)	\$4,709.52	\$14,159.52
Less rebate of 10% on pension	N/A	\$3,000.00
Net tax payable	\$4,709.52	\$11,159.52

The difference of \$6,450.00 between the income tax payable by Person A and the income tax payable by Person B represents a relative marginal tax rate of 21.5% on the pension received by Person B, rather than the stated intention of 15% required to ensure symmetry.

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To give proper effect to the intention of the proposal contained in the Document, it would therefore be necessary to ensure that the rate of tax on the pension was limited to 15%.

This could be achieved by increasing the rebate applicable to such pensions to a level necessary to result in the pension being taxed at a maximum of 15%. Such a treatment has often been used in setting taxation rates on certain income, so using this procedure would not be an unusual or novel solution.

It is trusted that the above is of some assistance. I would also be prepared to add any further explanation or comments that you may require. I can be contacted at the above address or by phone on XXX XXX XXX.

Yours truly,

(Joseph Orland)