

IJS\1005634\01139875.doc

2 August 2006

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

Dear Sir/Madam

REFORM OF THE AUSTRALIAN SUPERANNUATION SYSTEM

Introduction

William Buck is a leading national business advisory firm offering a comprehensive range of services to public and private clients including institutions, corporates, family businesses and SMEs. We assist our clients to capitalise on opportunities, mitigate risk and create value.

William Buck has a proud heritage of offering business advisory and professional chartered accounting services as we have done so for over 110 years. William Buck is a key member of AGN International, with affiliations in over 78 countries with more than 482 offices worldwide including the Americas, Europe and Asia.

With over 520 qualified professionals and offices in every state, William Buck is the only multi-disciplined firm capable of offering a complete range of professional services.

The Reform of the Australian Superannuation System

I refer to the announcements by The Treasurer, the Hon. Peter Costello MP on 9 May 2006 to simplify and streamline superannuation.

I am of the view that the changes proposed will be welcomed by our client base of family businesses and SMEs. Providing for the retirement incomes of Australian taxpayers is a key concern for Australia and I am of the view that any measures which seek to encourage Australians to save for their retirements and maintain their lifestyles during their retirements should be commended.

As has been made clear in the detail of the announcements to date, the broad emphasis of the proposed reform is to make superannuation benefits paid from a taxed fund, either as a lump sum or as an income stream such as a pension, to be tax free for people aged 60 and over. Given this it is only equitable to cap the level of contributions that taxpayers can make on an annual basis.

However the measures need to be drafted in a manner that is equitable to those taxpayers who have operated under the existing rules on the basis that the existing rules would continue. Also small business taxpayers need, and in my opinion deserve, special attention to take into account their peculiar situations and to recognise their contribution to the Australian economy.

With this in mind, most of my recommended amendments to the proposal relate to small business taxpayers.

48 Greenhill Road, Wayville SA 5034

T (61 8) 8272 2333 F (61 8) 8272 1972 E info@williambucks.com.au W www.williambuck.com.au

William Buck is an association of independent firms, each trading under the name of William Buck in Melbourne, Sydney, Brisbane, Adelaide, Perth and Cairns • Affiliated with AGN International

melbourne sydney brisbane adelaide perth cairns

strategic advice innovative solutions service excellence

Recommended amendment 1: Increase the exemption to the post-tax contributions 'cap' in respect of Small Business Taxpayers

In Press Release No. 57 dated 13 June 2006 The Treasurer, The Hon. Peter Costello MP outlined the operation of the '3 year average'. Both the '3 year average' and the proposed exemption to the 'cap' for the CGT exempt component from the sale of a small business will allow taxpayers to accommodate larger one-off payments. However in my view those exemptions to the 'cap' do not go far enough for small business taxpayers.

In the Second Reading Speech to the Taxation Laws Amendment Bill (No. 3) 1997 in relation to the amendment to a predecessor provision to the Small Business Retirement Exemption contained in Subdivision 152-D of the Income Tax Assessment Act 1997 the Parliamentary Secretary (Cabinet) to the Prime Minister, the Hon. Chris Miles MP said:

The CGT retirement exemption will be welcomed by thousand of small business operators. Owners of small businesses often need to reinvest earnings into their business to sustain growth and increase profitability. These individuals are sometimes not financially able to contribute to superannuation on a regular or even occasional basis. This measure offers a way in which those individuals can place accumulated capital gains into the superannuation environment without making regular contributions.

Small business assets are generally not able to be realised on a regular basis by individuals or their business entities to make superannuation contributions for their retirement. Allowing an exemption to the 'cap' of only the amount of the CGT exempt component does not provide sufficient incentive to small business operators who treat 'their businesses as their superannuation'. It is the value of their businesses (and not just the capital gain from the sale) that represents 'their superannuation'.

For individuals making capital gains in respect of small business assets the CGT exempt component represents one quarter of the what is often referred to as the 'nominal capital gain' (i.e. the capital gain before allowing for the 'discount' under Division 115 and the 'small business 50% reduction' under Subdivision 152-C). Accordingly it is four (4) times the CGT exempt amount represents the amount of the nominal capital gain that is exempted by the various concessions. Generally (but not always) that amount is the entire 'nominal capital gain'.

I would therefore recommend that four times the amount of the CGT exempt component be exempt from the 'cap' rather than the amount of the CGT exempt component.

Recommended amendment 2: That the amount exempted from the 'cap' for Small Business Taxpayers be available on pre-CGT assets

The exemption from the 'cap' for the CGT exempt component (or four times that amount if my recommended amendment number one is adopted) would seem to be only available if the small business asset sold was subject to CGT. Accordingly the exemption from the 'cap' for the CGT exempt component would not be available to taxpayers in respect of the disposal of assets acquired prior to 20 September 1985 (as the capital gain is 'disregarded' before the Small Business CGT Concessions are applied).

I can see no equitable reason why the exemption from the 'cap' on contributions should only apply to assets acquired after 19 September 1985.

A simple example showing the anomaly is as follows:

An individual acquired an asset which has been used in his/her small business for \$100,000. The asset has a current value of \$2,100,000. The capital gains calculations and the amount that can be contributed into super are as follows:

Asset acquired:	Post CGT	Pre CGT
Sale Price	2,100,000	2,100,000
Cost Base	<u>100,000</u>	100,000
'Nominal Capital Gain'	2,000,000	2,000,000
Discount	<u>1,000,000</u>	N/A
'Discounted Capital Gain'	1,000,000	N/A
Small Business 50% reduction	<u>500,000</u>	N/A
Subtotal	500,000	N/A
CGT Exempt Component under Small Business Retirement Concession	<u>500,000</u>	N/A
Net Capital Gain	0	N/A*

* Capital Gains on assets acquired before 20/9/85 are ignored

Amount that can be put into super

Undeducted contribution#	450,000	450,000
Deducted contribution	50,000	50,000
CGT Exempt Amount	<u>500,000</u>	<u>0</u>
	1,000,000	500,000

Assuming the '3 year average' is able to be met.

In my experience it is often difficult to obtain accurate details as to the cost base of pre-CGT assets. If the cost base can not be obtained then the amount exempted from the 'cap', if based on the actual capital gain made, can not be calculated.

On the grounds of simplicity the amount of the exemption should be the lifetime limit of the CGT exempt amount (i.e. \$500,000) or four times that amount (to be consistent with my recommended amendment 1 if that amendment was adopted).

Recommended amendment 3: That the amount exempted from the 'cap' for Small Business Taxpayers be available if the Small Business 15 year exemption applies

The exemption from the 'cap' for the CGT exempt component (or four times that amount if my recommended amendment 1 was adopted) would seem to be only available if the small business asset sold was subject to CGT and the small business retirement exemption under Subdivision 152-D was claimed.

Accordingly the exemption from 'cap' would not be available to taxpayers in respect of the disposal of assets where the Small Business 15 year exemption under Subdivision 152-B was claimed.

There is no equitable reason for this.

There should be an exemption from the 'cap' for the contribution of some (or all) of the capital gain when the Small Business 15 year exemption is applied.

Some alternatives for consideration might include exempting from the 'cap':

1. the 'notional' CGT exempt amount being one quarter of the 'nominal capital gain';
2. an amount equivalent to four times the 'notional' CGT exempt amount – i.e. the 'nominal capital gain' (in line with my recommended amendment one above); or
3. an amount equivalent to the lifetime limit of the CGT exempt amount, namely \$500,000.

Recommended amendment 4: That the work test not apply for Small Business Taxpayers in respect of the contributions made before age 65 under the '3 year average'

The fact sheet *A plan to simplify and streamline superannuation -: Post-tax contributions* (http://www.simplersuper.treasury.gov.au/fact_sheets/factsheet_post-tax_contributions.asp) contains the following discussion:

How would the work test rule for people aged 65 and above apply to the averaging provisions?

When a person reaches age 65 they can only make post-tax superannuation contributions during a financial year if they work at least 40 hours during a 30 day period. Superannuation contributions cannot be made once a person reaches age 75 (unless they are required under an industrial award).

*The proposed averaging arrangements would allow a person to bring-forward their entitlement to make \$150,000 in the next two years. For example, a person who is age 64 would be able to take advantage of the averaging arrangements provided they satisfied the work test in the following years. **A person who makes a \$300,000 contribution at age 64 would need to satisfy the work test at age 65. If the person did not satisfy the work test at age 65 the contributions would be returned to them and the earnings on the excess contributions would be effectively taxed at the top marginal tax rate (emphasis added).***

As mentioned above, Small Business Taxpayers are often unable to make regular superannuation contributions and are often only able to make larger contributions to 'catch up' closer to their retirement.

I would recommend the removal of the work related test in respect of any contributions by Small Business Taxpayers made before the age of 65 under the '3 year average'.

Recommended amendment 5: That the '3 year average' exclusion to the contributions 'cap' be maintained indefinitely

In Press Release No. 57 dated 13 June 2006 The Treasurer, The Hon. Peter Costello MP explained the operation of the '3 year average' by reference to an example of contributions made in the period 10 May to 30 June 2006, the 2006/07, 2007/08 and 2008/09 financial years.

The Press Release was silent on whether the '3 year average' would apply in relation to contributions after the 2008/09 financial year.

I can see no reason why the '3 year average' should not be maintained to allow people to accommodate larger one-off payments in the future.

I would recommend that the '3 year average' continue indefinitely.

Recommended amendment 6: That all death benefits from taxed funds be tax free regardless of the components of the benefit

Under the proposed arrangements, all lump sum death benefit payments would be tax free if paid to a dependant. Lump sum payments to non-dependants would be taxed at 15 per cent.

This can create unequitable outcomes for the families where the death of the member is unexpected.

Consider following example:

A person aged 60 (or more) has a superannuation balance of \$500,000 (all taxable component). She has no 'dependants', her husband having died previously, but has two adult children. If the person is diagnosed with a terminal illness she could withdraw her entire superannuation balance tax free before death. The \$500,000 could pass to her adult children tax free under her will. If however she died through an accident (and therefore could not withdraw her superannuation before her death) her children would be liable for \$75,000 of tax on the death benefit.

Removing the tax on all death benefits would prevent this anomaly.

I recommend that all death benefits from taxed funds be tax free regardless of the recipient.

In the alternative the introduction of a threshold (such as an amount equally to the current pension RBL which is indexed annually with AWOTE) under which the taxable component of benefits paid to non-dependants tax free should be considered.

Untaxed components continue to be tax free regardless of the recipient.

Recommended amendment 7: That an amount equivalent to the current pension RBL continue to be 'protected' in bankruptcy

In Joint Media Release No. 056 on 27 July 2006 by the Attorney-General, The Hon. Philip Ruddock MP and the Minister For Revenue & Assistant Treasury, The Hon. Peter Dutton MP, in respect of the amendments to the Bankruptcy Law regarding superannuation contributions made with the intention to defeat creditors, it was stated that:

The amendments will prevent unscrupulous debtors from transferring assets into superannuation when bankruptcy is looming. However, genuine contributions to superannuation for retirement income purposes will be protected from recovery.

In drafting the legislation in respect of the proposed superannuation reforms the implications of the removal of any references to the pension RBL should be considered in respect to the Bankruptcy Act so that the current position is maintained (with appropriate changes addressing contributions made to defeat creditors).

Consequential amendments: That the notion of 'Small Business Taxpayer' for the superannuation proposals be consistent with the Income Tax Assessment Act and include where relevant 'connected entities'

In Press Release No. 39 dated 9 May 2006 The Treasurer, The Hon. Peter Costello MP outlined a package of measures to assist small businesses by improving the alignment of eligibility thresholds for small business concessions.

The Small Business CGT Concessions recognise that businesses and business assets may be held in entities controlled by individuals, and not just in individuals' own names.

Any amendments to the superannuation proposals should be consistent with the changes to the Income Tax Assessment Act and the provisions of the Small Business CGT Concessions to provide the greatest possible opportunities for small business taxpayers and to reduce complexity and compliance costs.

Conclusion

I urge the Federal Government to make the most of this opportunity to simplify and streamline superannuation. Significant attention should be given to the peculiar circumstances of Small Business Taxpayers.

Yours sincerely

William Buck (SA) Pty Ltd
ABN 92 007 900 076



**Ian Snook
Director**