

24 May 2006

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

By email: simplersuper@treasury.gov.au

Dear Sir or Madam,

RE: A PLAN TO SIMPLIFY AND STREAMLINE SUPERANNUATION SUBMISSION

I refer to your invitation for submissions regarding 'A plan to simplify and streamline superannuation' ("the plan"), and provide my views in this letter. As a practitioner providing accounting, tax and advisory services to small and micro businesses, and to individuals, my suggestions are based on the simplification of the superannuation and taxation system and alignment of taxation policy with social priorities.

This submission has not sought to provide any specific comments on the areas of the plan that I consider are beneficial, but has instead chosen to focus on areas where further or alternative consideration should be given.

The areas of the plan that I believe should receive attention are, in summary, in relation to the following:

Proposals contained in the plan

- The proposed changes to the reporting requirements for benefit payments;
- The (lack of) changes to preservation arrangements;
- The reporting requirements for contributions;
- The (lack of) reference to indexation of the pre-tax contributions threshold;
- The (lack of) reference to indexation of the post-tax contributions threshold;
- The proposed consideration of averaging the post-tax contributions threshold;
- The interaction of the post-tax contributions threshold and the government's co-contribution;
- The simplification of the rules that determine a person's eligibility to claim a deduction for personal contributions;
- The streamlining of dates for changes to pension arrangements;
- The taxation of contributions where no tax file number has been quoted;
- The ability to accept contributions where no tax file number has been quoted;
- The repatriation of lost superannuation fund balances with members;

In addition, submissions have been attached in relation to matters not raised in the plan, in relation to the following:

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> Accounting <> Tax <> Advisory <

Other proposals

- The audit of self managed superannuation funds
- The maximum number of members allowed in self managed superannuation funds
- The timing of the deduction for superannuation contributions
- The drafting of superannuation legislation

My detailed comments on the above issues are provided in the following pages.

Thank you for the chance to provide my views regarding priorities for the 2006-07 Budget, and specifically to indicate the opportunities available for the government for improving the operation of the taxation system.

Yours faithfully,

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Scott Kerrison

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MANAGING DIRECTOR

Proposals contained in the plan

Note: Any quoted references below are extracts from the Detailed Outline of the document A Plan to Simplify and Streamline Superannuation.

Taxation of benefit payments

Reporting requirements

The plan suggests that “superannuation funds would not need to report benefit payments to the ATO for RBL purposes”.

The removal of the superannuation surcharge may have been expected to result in the removal of the requirement to notify the ATO of contributions received by superannuation funds. However, this has proven not to be the case, with detailed disclosure of the contributions received for each member and their fund balance required to be reported.

Although benefit payments may not need to be reported for RBL purposes under the plan, concern must be held that other reasons will be found to require that benefit payments are reported. The removal of a reporting requirement for one purpose, only for it to be replaced by the same or similar reporting requirement for another purpose provide no net benefit to superannuation fund members or administrators.

Recommendation: In order to alleviate the concern identified, the plan should further provide that superannuation funds would not be required to report benefit payments to the ATO (or any other government body) for any purpose.

Payment rules simplified

Preservation age

The plan proposes no change to the preservation age, which is noted “to increase from 55 to 60 between the years 2015 and 2025”.

The employment market is already experiencing significant shortages of workers across numerous industries. Accordingly, increased efforts must be made to ensure that not only is the supply of new workers to the employment market increased, but that the retention of existing working is maximised. A well structured retirement incomes policy can assist in this outcome, by reducing the ability of workers to leave the workforce early and access retirement benefits.

With the continuing tightening of the employment market, more must be done to limit the leakage of employees from the workforce.

Recommendation: The changes to the preservation age from 55 to 60 should be phased in sooner. Alternatives to achieve this outcome could include increasing the preservation age from an earlier date (for example, from 2010, rather than 2015), increasing the speed of the increase (for example, increasing the preservation age from 55 to 60 between the years 2015 and 2020, rather than 2015 and 2025), or some combination of these.

Simplified contribution rules

Administrative arrangements

Under the plan, “superannuation fund reporting requirements would provide the ATO with enough information to assess contributions tax liabilities”, with particular regarding to the assessment of any pre-tax contributions made in excess of the proposed annual threshold of \$50,000.

It should be noted that superannuation fund reporting requirements already include providing the ATO with the ‘superannuation member contributions statement’, which includes the disclosure of employer contributions for each superannuation fund member (along with other contributions details). Accordingly, no additional form or disclosures should be required under this proposal. However, this ‘superannuation member contributions statement’ should be reviewed to ensure that no more information is requested than is required to administer taxation law. While the lodgement of an income tax return is an accepted cost of operating a superannuation fund, any further reporting requirements, particularly when required at different times or when providing the same information in different formats, adds unreasonable and unnecessary costs.

Recommendation: The ‘superannuation member contributions statement’ form should be reviewed to ensure that no more information is requested than is required to administer taxation law. Consideration should also be given to including the ‘superannuation member contributions statement’ reporting requirements as part of the income tax return reporting, to minimise the additional work required and the duplication of effort in complying with taxation laws.

Pre-tax contributions

The plan proposes that the current aged-based deduction thresholds be replaced with a flat annual threshold of \$50,000 per person. It would further appear that this change in thresholds is accompanied by a removal in the indexation of the threshold.

Under the existing system, the aged-based deduction thresholds are indexed each year in line with average weekly ordinary times earnings (AWOTE). Nowhere does the plan indicate that the \$50,000 threshold will be indexed. This threshold must be subject to indexation, either in line with AWOTE, or by some other measure that maintains the real value of the contribution limit. If the threshold is not indexed, we will likely see successive governments provide “tax cuts” by adjusting the threshold upward to take account of inflation, when this indexation should be provided fundamentally as part of the plan.

Recommendation: The annual pre-tax contribution threshold of \$50,000 should be indexed annually in line with movements in AWOTE.

Post-tax contributions

The plan proposes that an annual post-tax contribution limit of \$150,000 will be imposed on members, in contrast to the current situation, where there is no such limit.

Under the existing system, superannuation fund members can contribute (or have contributed on their behalf) an unlimited amount. This has been particularly beneficial to those who have sold their business, or disposed of an investment property and do not have a

pressing need for some or all of the net proceeds. While the capping of post-tax contributions is recognised as the price for the removal of reasonable benefits limits and tax on superannuation payments, nowhere does the plan indicate that the \$150,000 threshold will be indexed. This threshold must be subject to indexation, either in line with AWOTE, or by some other measure that maintains the real value of the contribution limit. If the threshold is not indexed, we will likely see successive governments provide “tax cuts” by adjusting the threshold upward to take account of inflation, when this indexation should be provided fundamentally as part of the plan.

The plan indicates that “the Government will consider whether the cap should be averaged over three years to allow people to accommodate larger one-off payments”. It should be noted that any such averaging of the threshold would add complexity to the otherwise simple proposal of a flat contribution threshold. Any superannuation fund member would not be significantly worse off by not allowing the threshold to be averaged, and could choose to make a total contribution of in excess of \$150,000 (or such indexed threshold as is introduced) by making contributions over a number of years.

While the plan proposes the annual post-tax contribution threshold of \$150,000 and mentions the government’s co-contribution scheme, it does not discuss the interaction of these two. Under the plan, both untaxed member-contributed amounts and the government co-contribution will be attributed as post-tax contributions. However, the government co-contribution will relate to a previous year’s member contributions (than does the member-contributed amounts). Therefore, it would be possible for a superannuation fund member to decide to contribute the maximum \$150,000 in a particularly financial year, and also receive a government co-contribution in that year as well (or potentially more than one co-contribution, depending on the timeliness of reporting by their superannuation fund). Under the plan, the excess of post-tax contributions in excess of \$150,000 would be returned to the member. An alternative would be for the \$150,000 to apply to post-tax contributions *other* than the government co-contribution.

Recommendations: The annual post-tax contribution threshold of \$150,000 should be indexed annually in line with movements in AWOTE.

The annual post-tax contribution threshold should be applied in each and every year (subject to the recommended indexation), and not averaged over a number of years.

The annual post-tax contribution threshold should apply to contributions other than the government co-contribution (which should be accepted irrespective of the level of other contributions made).

Personal deduction eligibility

The plan proposes that “the rule that determines a person’s eligibility to claim a deduction for personal contributions be simplified” by aligning the test with that currently used for determining eligibility for a government co-contribution.

The test should be simplified even further than that proposed by the plan, by allowing any individual to claim a deduction for personal contributions. The test should not be determined by an assessment of the level or percentage of their income derived from employment, but instead should simply be allowed as a specific deduction for any taxpayer. As such a deduction may result in an individual reporting an income tax loss for a financial year, it is recommended that the deduction would not be allowed to create or increase a tax loss.

Some employers will not allow employees to salary sacrifice in superannuation, or otherwise will pay the superannuation guarantee only on the ordinary times earnings of the employee net of the sacrificed amount (which is their right under the law, notwithstanding that many employers choose to maintain superannuation contributions at their original level). These employees should not miss out on the opportunity to contribute to superannuation in a tax-effective manner, due only to the policies of their employer.

Recommendations: The test for claiming a deduction for personal superannuation contributions should be allowed as a specific deduction for any taxpayer, and not by reference to the level or percentage or income derived from employment.

Such a deduction should be limited such that it cannot create or increase a tax loss in any financial year.

Contribution incentives for the self-employed

No comments.

Age pension arrangements

Implementation dates

Under the plan, “it is proposed that the pension assets test taper rate be halved from 20 September 2007”, and “the current 50 per cent assets test exemption for ‘complying’ income streams would be removed from 20 September 2007”.

Except for the fact that 20 September 2007 represents three years since the previous changes were made to age pension arrangements, there appears no other justification for selecting this date, rather than some other date. On the basis that all other proposed future changes will take effect from 1 July 2007 (the proposed changes to introduce a post-tax contributions threshold is anticipated to take effect from 9 May 2006), the changes to the age pension arrangements should likewise take effect from this date. This would further simplify the proposal.

Recommendations: The pension assets test taper rate should be changed with effect from 1 July 2007, not 20 September 2007.

The 50 per cent assets test exemption for ‘complying’ income streams should be removed from 1 July 2007, not 20 September 2007.

Other measures

Taxation of contributions without a tax file number

The plan proposes that “where a tax file number has not been quoted to a taxed fund, the top marginal rate would apply where taxable contributions to that fund for a member exceed \$1,000”.

The basis for exempting situations where taxable contributions do not exceed \$1,000 is predicated on this “minimis(ing) compliance costs for the superannuation industry”. On the contrary, imposing such an arbitrary threshold actually increases the compliance costs, as it is exceptions to a rule that impose the complexity. Assuming that taxable contributions are

to be accepted by a fund where no tax file number has been quoted (see the following recommendation), the compliance costs would be minimised instead by applying the taxation treatment consistently irrespective of the level of taxable contributions by or on behalf of a member.

Recommendation: There should be no threshold exemption below which tax would not be assessed at the top marginal tax rate where no tax file number has been quoted (assuming that a superannuation fund should accept contributions in such a situation – see the following recommendation).

Acceptance of contributions without a tax file number

The plan proposes that “superannuation fund trustees would ... only be able to accept undeducted contributions for or on behalf of a member, if the member’s tax file number has been quoted to the trustee”.

It is not clear from the plan why this proposal should not be extended to pre-tax contributions in addition to the post-tax contributions (undeducted contributions). Given the significant level of lost and unclaimed superannuation balances that currently exist, the requirement for all superannuation fund members to provide their tax file numbers would greatly assist to reduce the degree of future lost and unclaimed superannuation. If superannuation funds were to require a tax file number from all members in order to accept any contribution, alternative arrangements would need to be established in the circumstance where a member chooses not to quote their tax file number.

Recommendation: Superannuation fund trustees should only be able to accept a contribution (whether deducted or undeducted) where the relevant member has provided a tax file number.

Untaxed schemes

No comments.

Making it easier to find and transfer superannuation

Under the plan, “the ATO would write to lost members advising them of the existence of their lost account and offering them a number of choices, including consolidating the account with an active account, or indicating that they are satisfied with the account’s inactive status”.

This proposal does not appear to fully deal with the issue of lost accounts. It would appear from the plan that if the member is “satisfied with the account’s inactive status”, then the superannuation fund would not be advised of the correct details of the member. Where the ATO has located the member of a lost superannuation account, the possible outcomes must all result in the fund balance no longer being ‘lost’. Clearly, where the member chooses to consolidate the balance with an active fund, this outcome will be achieved. However, allowing the member to accept the “inactive status” would appear to retain the balance’s ‘lost’ status.

Recommendation: The proposals for repatriating lost balances must result in the repatriation of funds to the member once the ATO has conclusively located the member of that lost account.

Other proposals

Audits of self managed superannuation funds

One of the most significant imposts on the trustees of self managed superannuation funds is the requirement to have an annual audit conducted of their compliance and of their accounts of the superannuation fund. It is an anomaly that superannuation funds require an audit, irrespective of their size, when other business and investment structures do not generally require an audit. Rather, most business and investment structures are trusted to meet their legal requirements of their own accord, usually in conjunction with the assistance of their legal and taxation advisors. The significant cost involved in the conduct of such audits is inconsistent with the desire of the plan to maximise retirement incomes.

Recommendation: Self managed superannuation funds should be exempted from the requirement to conduct an annual audit of their compliance and of their accounts.

Maximum numbers of members allowed in self managed superannuation funds

Under the law as it currently stands, the maximum number of members allowed in a single self managed superannuation fund is four. To have any larger number of members in the fund, an APRA-regulated fund must be used. As the predominant users of self managed superannuation funds are 'mums and dads', the limit of four members is overly restrictive on fund membership. This limit prevents a family with two parents and three or more children and also impedes the possibility of inter-generational membership of the fund. The current solutions to this problem are either setting up multiple funds or alternatively selecting an APRA-regulated fund. Both of these options impose additional costs that cannot be support by the additional benefits that it provides.

Recommendation: The maximum number of members allowed in a single self managed superannuation fund should be expanded to allow for larger family groups to be members of a single fund.

Timing of deduction for superannuation contributions

At present, the deductibility of superannuation contributions is governed by a specific deduction provision in the Income Tax Assessment Act 1936 ("the 1936 Act"). The deductibility provisions allow a deduction for superannuation 'paid'. This is inconsistent with the general deductibility requirement of 'incurred'. On the basis that accrued wages are accepted as an allowable deduction (which, in broad terms, are the basis for incurring a liability to make superannuation contributions), it is anomalous that superannuation must be paid before a deduction is allowed.

Recommendation: The ability to claim a deduction for superannuation contributions should be aligned with the general requirement for a loss or outgoings to be incurred. This may be modified to require that the amount actually be paid within a certain timeframe after the end of the financial year, but subject to the payment being made within that timeframe, a deduction should be allowed for superannuation in the financial year in which it is incurred.

Drafting of superannuation legislation

The taxation of complying superannuation funds is currently contained in the Income Tax Assessment Act 1936 ("the 1936 Tax Act"). However, with the significant interaction of these provisions with the Income Tax Assessment Act 1997 ("the 1997 Tax Act"), and with the plan to simplify and streamline superannuation, the opportunity should be taken to re-write all the existing provisions and transfer them to the 1997 Tax Act. The work on re-writing the 1936 Tax Act appears to have largely ceased since the drafting of the legislation to enact a goods and services tax was begun. With the significant reform of superannuation arrangements, this opportunity should be taken to remove another part of the legacy 1936 Tax Act.

Recommendation: All superannuation provisions that are currently contained within the 1936 Tax Act should be re-written and transferred to the 1997 Tax Act (with such amendments as required to implement the agreed changes to superannuation arrangements).