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The Treasury
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13 July 2006

Submission in response to the Governments proposals to simplify and streamline superannuation (May 2006)

Dear Sir/Madam

The attached submission addresses a number of key issues arising from the proposals for the simplification and streamlining of the current superannuation system, announced by the Treasurer on Budget night.

The proposals have much to commend, but importantly, there are also a number of anomalies that need to be addressed in order to ensure more equitable outcomes and in order to preserve consumer confidence in the broader superannuation system.

Specifically, we see scope for the following amendments:

- The extension of transitional contribution arrangements
- Employed persons to be allowed to make lump sum taxed contributions
- Transparent management of the future levels of the new contribution thresholds
- A new benchmark to be established for the employee-initiated suspension of SGC contributions.
- Preservation ages to be rationalised, providing access to transitional retirement arrangements for all Australians from age 55 years

We would value the opportunity to further discuss these proposals with Treasury and the Minister's Office.

Yours faithfully

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BOWRAL BRANCH

Submission in Response to the Government's Proposals to Simplify and Streamline Superannuation (May 2006)

Thursday, 13 July 2006

Business Principles:

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1.0 EXECUTIVE SUMMARY

This submission briefly reviews the efficiency of the current superannuation arrangements and specifically seeks to address some of the current misnomers relating to the way member contributions, earnings and withdrawals are taxed.

A number of refinements, as summarised below, are specifically proposed to further enhance confidence in the superannuation system and to provide the certainty that people need in making their future investment and retirement plans:

- **Fairer transitional arrangements are required for the introduction of the new contribution arrangements (page 6).** As with other initiatives proposed in the Budget, the contribution changes should also take effect from 1 July 2007 and a higher transitional threshold of \$300,000pa for non-taxed contributions should be applied over the subsequent 5 year period.
- Employed persons should be given the same opportunity as the non-supported (self-employed) to **make lump sum taxed contributions into superannuation (page 8)**. It is appropriate that the Budget proposals have sought to remove some of the existing anomalies for the self-employed, but the playing field should also be leveled for employed persons.
- **Transparency is required in how the new concessional contributions limit (CCL) is managed** over time (page 8). We would recommend that the CCL threshold be adjusted annually with **AWOTE** and that the post-tax contribution limit be legislated at **3 times** the CCL.
- With the abolition of RBL's, there is a need to establish **a new benchmark at which SG contributions become optional** at the employee's discretion (page 8). People who have catered early and adequately for their retirement should continue to be given flexibility to re-negotiate this benefit with their employer.
- The preservation ages should be rationalised (**page 9**). All superannuants should be able to **commence a transition to retirement pension (ie non-commutable income stream) from age 55 years**. The optional retirement age for all Australian's should be set at age 60 years.

We envisage that these changes will add further equity to the package of proposals announced by the Government and, in aggregate, would be expected to have minimal fiscal impact.

2.0 CONTEXT

It is appropriate to spend a little time at the outset commenting on the effectiveness of the current superannuation system, specifically with respect to the issue of taxation and how it acts as either an incentive or deterrent.

2.1 Contributions

There is a myth that seems to be perpetuated by certain consumer and industry groups that contributions tax serves as a disincentive to making contributions and that its affect on accumulated benefits is inequitable. The reality is that an overwhelming number of Australian employees are able to make additional superannuation contributions from pre-tax earnings. Hence, any election by an employee to voluntary increase their level of superannuation contributions via salary sacrificing actually results in reduced taxation being payable.

On an average salary of \$54,000 (using 2006/07 tax scales), an individual could sacrifice an extra \$5,000 into superannuation with a net benefit of 15 cents in the contribution dollar or \$750:

	Before	After
Gross Salary	\$54,000	\$54,000
Less : Salary Sacrifice	<u>0</u>	<u>5,000</u>
Taxable Income	54,000	49,000
Tax Payable (06/07 rates)	<u>11,550</u>	<u>10,050</u>
Net Income	42,450	38,950
Extra Super Benefit	0	5,000
Less : Contributions Tax	<u>0</u>	<u>750</u>
Net Super Benefit	0	4,250
Total After Tax Income/Benefit	\$42,450	\$43,200

This net tax benefit (effectively marginal tax rate (MTR) less contributions tax), is mischievously not acknowledged by those in the community who are single mindedly campaigning for a reduction in, or abolition of, contributions tax.

The other reality is that non-taxed (or undeducted) contributions can be made into superannuation at any time **without** the application of contributions tax.

Given the proposed removal of income tax from end benefits, the contribution thresholds that are now being contemplated are an entirely appropriate fiscal limiter and an incentive for all Australian's to start making additional contributions at an earlier stage. However, more equitable transitional arrangements are essential for those older individuals who have been planning their retirement incomes strategy around the previous superannuation arrangements and who are now unable to retrospectively re-structure their contributions and investments.

Alternative transitional arrangements are proposed at section 3.1 (page 6).

2.2 Earnings

By comparative standards, earnings taxed at 15% inside superannuation is an attractive arrangement. If there were fiscal scope at some future stage, a reduction to this rate of taxation would obviously assist to accelerate the retirement savings of all Australians. There may also be some merit in the level of earnings tax being applied at a rate that represents a discount to an individual's MTR. For example, earnings tax could be applied at one third of an individual's marginal tax rate in any particular year. That is, if your MTR was 45%, your fund would pay 15% earnings tax; if your MTR were to be 30%, your fund would be taxed at 10%.

2.3 Withdrawal

The proposed "nil tax" arrangements for those over 60 years of age, together with the simplified taxation treatment applying to benefits withdrawn by those below this age, will certainly removed a good deal of the complexity in the current system. The Reasonable Benefits Limit (RBL) regime created significant complexity for individuals, advisers/tax professionals and the Australian Tax Office. Its abolition goes an enormous way to enshrining simplicity within the pension phase of the superannuation system.

We do hold some concern about the proposed extension of tax-free arrangements to all pension withdrawals. Whilst we have made no specific comment or recommendations about this initiative, as it most probably has broad based community appeal, we see the availability of uncapped lump sum withdrawal as having the potential to dilute the long term benefits of Superannuation.

3.0 RECOMMENDED ENHANCEMENTS

3.1. Enhanced Transitional Contribution Arrangements

A wide variety of individuals have developed strategies to accumulate growth assets outside of superannuation (both investment and lifestyle – with a good proportion geared), with a view to contributing net proceeds into superannuation prior to retirement.

These people should be afforded the opportunity to unwind this planning without undue penalty.

By effectively outlawing (or materially limiting the effect of) these strategies over night, the Government risks further undermining confidence in the superannuation system. Part of the resistance that people currently have to superannuation is the concern that the Government can change their minds over night and de-rail peoples planning. It is therefore critical for changes to be phased in over a reasonable period (ie people given some fore-warning of the change) and that equitable transitional arrangements are agreed.

The benefit that this relatively small group of individuals would derive from being allowed to make post-tax (or undeducted) contributions into superannuation would not be disproportionately large. There would be no deductibility on the contributions and the fiscal cost to the Government would simply be in terms of the level of out year earnings tax applicable to these amounts (as per the current arrangements).

The benefit to the individual would be the simplicity that comes from having a single source for pension income (as currently planned), avoiding the need to manage multiple asset types and tax consequences.

There would also be reputational benefit for the Government and the superannuation system more generally, with individuals comforted by the fact that where change to the superannuation system is contemplated, it is not “quasi retrospective” and non-discriminatory transition arrangements are applied.

Strangely, it is proposed to allow one group of asset owners a continued contribution concession – namely, small business owners, who will retain an exemption for contributions from capital gains of up to \$500,000. For husband and wife business owners, this would mean the opportunity to contribute an additional \$1,000,000 to superannuation over and above the new contribution limits.

Equitable transition arrangements need to be put in place for all Australians, not just a select few.

It is noted that all other announcements (including the removal of concessional weightings for complying income streams) are due to take affect from 1 July’07. In the **interests of fairness, changes to contribution arrangements should be likewise timed.**

The following case studies summarise the personal circumstances of a cross-section of our clients who will be adversely affected by the proposed changes to contribution arrangements:

3.1.1 CASE STUDY 1 – Single Female Approaching Retirement

Ms X is 53 years of age and recently divorced, she supports her two university aged children. At the time of her divorce settlement (in 2004) Ms X was fighting several major cancers and it was agreed that funds should be invested in her personal name as a temporary measure until she was well enough and could fully understand the issues surrounding superannuation, allocated pensions, beneficiaries and preservation, prior to making an investment. A review conducted in March 2006 confirmed the long term merits of creating an allocated pension and the realisation of assets began so that an undeducted contribution of \$3,500,000 (her divorce settlement) could take place.

3.1.2 CASE STUDY 2 – Husband and Wife Property Developers

Mr and Mrs Y are aged 63 and 64 respectively. They have accumulated their wealth of many years through property acquisition and development. They have been clients for 3 years and their financial plan has been premised on the fact that they would progressively dispose of their property holdings (many of which were listed for sale prior to 9th May 2006) over the next 2 years in the lead-up to their retirement on 1 July 2008.

3.1.3 CASE STUDY 2 – Single Business Owner (Listed Company)

Mr Z is aged 53 and has accumulated the majority of his personal wealth by founding, expanding and running a company that ultimately listed on the ASX. In March of this year we prepared a financial plan that revolved around the sale of his personal share holdings with the proceeds being contributed to superannuation as an undeducted contribution.

All of these clients have put strategies in place based on the known requirements of the superannuation system at the time; with Mr Z and Ms X having to meet establishment costs for structures that now have limited use and appeal.

In the circumstances, we recommend that:

- **The current uncapped, undeducted contribution arrangements be extended until 30 June 2007**
- **That for the following five years (ie until 30 June 2012), the undeducted contribution limit be set at \$300,000 pa for those age 50 years or over, with provision to consider averaging over the entire transitional period for one-off contributions (For example, where someone down-sizes a residence just prior to retirement during the transitional period, then a one-off contribution of up to \$1,500,000 would be acceptable.)**

3.3 Allow Employed Persons to make Lump Sum Taxed Contributions

The Budget proposals have rightfully sought to remove a number of the inequities that have historically disadvantaged the self-employed. The availability of full tax deductibility for contributions over \$5,000 and the extension of the co-contribution arrangements are to be applauded as measures that make the system more equitable for the self-employed.

However, employed persons now do not enjoy the full range of opportunities available to the self-employed – specifically, the opportunity that the self-employed have to make lump sum taxed contributions.

This flexibility and incentive needs to be extended to employed persons, over and above simply salary sacrificing which requires significant forethought and planning.

Employed persons should be given the opportunity to make lump sum contributions of (say) bonuses, inheritances or other windfalls at the time of their receipt or at the end of the financial year. The contributions limits will ensure that there is no abuse of this arrangement and, in introducing such an arrangement, the Government will alleviate the hassle and significant pre-meditation associated with the current salary sacrificing arrangements.

3.4. Transparency in Managing the Contribution Thresholds

Government discretion with respect to the contribution limits should be removed via legislation to ensure that thresholds must be managed in a transparent manner going forward.

The proposed concessional contribution limit of \$50,000 should be indexed each year by AWOTE and the higher, post-tax contribution limit should be set as a three-fold multiple.

This should be an automatic adjustment on 1 July each year.

People are skeptical about an arbitrarily set benchmark that can be varied according to the fiscal and/or political whim of a Government. Transparently managing such a threshold generates confidence and certainty within the system.

3.5. New Benchmark for the Employee Initiated Suspension of SG Contributions

Under the current arrangements, individuals who have more than adequately provided for their retirement future are given the option of being able to direct their employers to suspend SG contributions once the accumulated balance of their superannuation fund have reached the level of the pension RBL (approximately \$1,200,000).

The amount of the SG contribution can then be received directly as income or as some other employment benefit

With the removal of tax on pension income, its hard to think of a better investment than continued contribution into the tax-preferred super environment. However, people may want to direct surplus savings to their children (eg university fees), or fund the maintenance of their lifestyle whilst winding down their working hours and transitioning to retirement.

Accordingly, the option to suspend SG contributions should be maintained into the future. The new benchmark could be set at 8 times the post-tax contribution limit (ie \$1,200,000).

3.6 Rationalisation of Preservation Ages

The Government's initiative to introduce transition to retirement allocated pensions (TRAPs or non-commutable income streams) in July 2005 has added widely appreciated flexibility in retirement planning for many Australians.

These new pensions are seen as an opportunity by many to wind-back their hectic working lifestyles and/or to venture out on new career paths before formal retirement.

This added choice has provided an enormous opportunity for many Australians at an age where they are still young enough to physically and mentally benefit from alternative work patterns.

In light of this success, it is argued that rather than linking access to the transition to retirement arrangements to the preservation age (which is set to increase over time), TRAPs should be accessible to all Australian's **at age 55 years**.

With a view to further simplifying current arrangements the optional retirement age for all Australian's should be immediately set at age 60 years. If someone chose to "retire" at age 55 years, they would be limited to the benefit provided by the TRAP (ie a pension payment and no lump sum access) and any amounts received would be subject to tax.

4.0 CONCLUSIONS

The Government's proposed changes to the superannuation system represent the first significant re-structuring of the system for many decades. They reflect an obvious and overdue desire to introduce further simplicity into the system. We believe that the proposed measures can be further supplemented by the enhancements outlined in this submission to add further equity.