

# 2010 BUDGET SUBMISSION TO TREASURY

February 2010

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Self-Managed Super Fund Professionals'  
Association of Australia Limited  
(‘SPAA’)

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## 2010 Budget Submission to Treasury

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### Purpose of Submission

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1. The Self Managed Superannuation Funds Professional Association of Australia (“SPAA”) welcomes the opportunity to make a submission to the 2010 Federal budget.
2. SPAA’s 2010 Federal budget submission focuses on initiatives which simplify the superannuation system and improve consumer confidence in it. SPAA considers that the initiatives referred to in this submission will improve the equity of the superannuation system and thereby encourage savings via superannuation.
3. SPAA acknowledges that there is no single measure that can achieve this but rather suggests that a number of incremental changes are required in the following areas:
  - i. Contributions caps and contribution acceptance tests
  - ii. Payment of death benefits to non-dependent beneficiaries
  - iii. Single versus multiple superannuation interests
  - iv. Tax treatment of exempt pension assets on death
  - v. SMSF residency status
  - vi. Anti-detriment payments
4. SPAA strongly encourages Treasury to view the taxation incentives afforded to superannuation, including those which may be implicit in our submission initiatives, in light of the Government’s stated policy objective of reducing reliance on the age pension and promoting self-funded retirees.

### About SPAA

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5. SPAA is the peak professional body representing the self managed superannuation fund (SMSF) sector throughout Australia. SPAA represents professionals, irrespective of their personal membership and professional affiliations, who provide advice to individuals aspiring to higher levels of participation in the management of their superannuation savings. Membership of SPAA is principally accountants, auditors, lawyers, financial planners and other professionals such as actuaries.

### Summary of SPAA recommendations

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6. Proposals and recommendations considered by SPAA to be worthy of inclusion in the 2010 Federal budget are:
7. **Recommendation No.1** – Contribution caps to be restored to their pre 2009/10 levels. Indexation of the caps to be based on the restored amounts.
8. **Recommendation No.2** – SIS regulation 7.04(3) be amended to ensure consistency with ITAA97 s292-85.

9. **Recommendation No.3** – The age 65 limit applying to members wanting to bring forward future years of non-concessional contributions be removed
10. **Recommendation No.4** – The introduction of the option for non-tax dependants to retain a death benefit in the accumulation phase without benefit taxation.
11. **Recommendation No.5** – Review and clarification of the concept of a “superannuation interest” in s307-200 of the ITAA97.
12. **Recommendation No.6** – Review and possible amendment to s295-F of the ITAA97 to ensure the tax exempt status of fund income is correctly understood and applied.
13. **Recommendation No.7** – That the “active member test” in s295-95(2) of the ITAA97 be abolished to ensure a more appropriate solution is provided.
14. **Recommendation No.8** – Introduction of discretion to the regulator under s42A(5) of the SIS Act to permit funds that fail the definition of an “Australian Superannuation fund” to retain their complying status in certain circumstances.
15. **Recommendation No.9** – Review and possible amendment to s295-485 of the ITAA97 to ensure all funds have equal and appropriate access to anti-detriment payments.

### **Contributions caps and contribution acceptance tests**

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16. SPAA is concerned that the reduction in the concessional contribution cap announced in the 2009 Federal budget, and the flow on indexation implications, will deny many individuals the opportunity of adequately saving for retirement, particularly those who are within 10 to 15 years of retirement.
17. The low cap base, together with absences of adequate indexation, will deny many thousands of Australian the opportunity of adequately saving for retirement.<sup>1</sup> In particular, there is a need for individuals with broken working patterns to be able to make catch-up contributions later in life - an opportunity which is currently denied by the current low level of concessional contribution caps.
18. It is clear from SPAA's experience large contributions are made by individuals across most income ranges. By focusing only on the high income earning sections of the population the impact across other income ranges is likely to have been significantly underestimated in Treasury's 2009/10 budget estimates.<sup>2</sup>
19. To enable individuals, including those with broken work patterns, to adequately save for their retirement, SPAA considers that the concessional contribution caps should be restored to their pre 2009/10 levels. In support of this proposal, SPAA urges Treasury to carefully consider the long term fiscal impact of the reduction in the concessional contribution cap across all income ranges, and not just the high income earning part of the population.
20. SPAA considers that the contribution acceptance tests in SIS regulation 7.04 and their interaction with ITAA97 s292-85 require amendment. Given the penalty rate of tax applicable to excess non-concessional contributions, SPAA considers that contributions in excess of the non-concessional cap would be by mistake rather than by intention. The fact that non-concessional contributions in excess of the cap have been made, indicates that the contribution rules applying to individuals over 65 are caught by the complexity of the contribution rules.
21. In SPAA's view, the principles outlined in ATO Interpretative decision ATOID 2008/90 are not well understood and are inconsistently applied by industry. In SPAA's experience, it is not uncommon to observe funds refunding non-concessional contributions under section 7.04(4) because the contribution when aggregated with other contributions made during the financial year are excessive.

<sup>1</sup> Assuming an annual indexation rate of 3% and working with a cap of \$25,000, it could be 8 or more years before any indexation is applied to the concessional contribution and non-concessional contribution cap (which is set at 6 times the concessional cap).

<sup>2</sup> The 2009 budget papers estimate that the reduction in the concessional contribution cap will impact less than 2% of individuals currently making non-concessional contributions.

22. A contributing factor seems to be the interaction between ITAA97 s292-85 and SIS Regulation 7.04(3) which enables a superannuation fund trustee to accept a non-concessional contribution which although in aggregate exceeds the member's non-concessional contribution cap, each individual contribution does not itself exceed the non-concessional contributions cap. The interpretation of the rule by the ATO requires a fund to refund the contribution when a particular contribution exceeds the non-concessional contribution cap.
23. SPAA is also aware of many situations where individuals over the age of 65 have mistakenly or inadvertently exceeded their non-concessional contributions cap. Further confusion arises for individuals aged 65 or over as at 1 July who had previously triggered the 3 year average contribution provision, and may therefore be entitled to contribute up to \$450,000 over three financial years. In this scenario, superannuation fund trustees cannot accept a non-concessional contribution from the individual which exceeds \$150,000 under SIS Regulation 7.04(3), despite this being permitted under ITAA97 s292-85(2). To counteract this, members are required to contribute multiple amounts with no one contribution exceeding \$150,000. To overcome these technical difficulties, SIS Regulation 7.04(3) should be amended to ensure it is consistent with ITAA97 s292-85(2).
24. Most of these instances demonstrate a clear misunderstanding of s292-85 and SIS regulation 7.04. To simplify the contribution caps for members over age 65 and to reduce instances of unintended contribution cap breaches, SPAA considers that the restriction which applies from age 65 to members who wish to bring forward two future years of non-concessional contributions, should be removed. This will allow the "bring forward rule" to apply until a fund member is age 75.
25. Under the previous reasonable benefits limits regime individuals and their advisers were often able to take remedial action to correct an unintended over-funded position. The current position with excess concessional and non-concessional contributions provides limited, and in many cases no, access to remedial action.<sup>3</sup>

## **Death benefits paid to non-dependent beneficiaries**

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26. There are inequalities and complexities associated with the payment of superannuation death benefits. A non-tax dependant is not permitted to receive a superannuation death benefit in the form of a pension or to retain the benefit in the superannuation system without first receiving a lump sum benefit and paying the applicable benefit tax. This inequity is further complicated by scenarios whereby the payment of a superannuation death benefit to a non-tax dependant is tax free because the member was "killed in the line of duty".
27. SPAA considers that requiring non-tax dependants to withdraw the proceeds of a death benefit is consistent with other measures designed to address the issue of adequacy and longevity. SPAA supports the introduction of an option for non-tax dependants to retain the proceeds of a death benefit as a preserved benefit in the superannuation accumulation phase by way of an internal, or fund to fund roll-over, without benefit taxation.
28. Enabling a non-tax dependant to retain the proceeds of a superannuation death benefit within the superannuation system, as opposed to being compelled to withdraw the benefit as a lump sum, will assist and encourage these individuals to ultimately generate an adequate and independent level of retirement savings.

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<sup>3</sup> Although under section 292-465 of the ITAA97, the Commissioner has the discretion to disregard contributions etc for the purpose of the contribution limits, given the matters which the Commissioner may have regard to in sub-section (5) and (6), it is unlikely that this discretion would apply in situations where individuals have mistakenly applied or interpreted the legislation.

## Single versus multiple interests

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29. Section 307-200 of the ITAA97 and the ATO fact sheet “How many superannuation interests does a member of a superannuation fund have in their fund” arguably gives rise to situations whereby a member may be considered to have multiple superannuation interests for the purposes of the proportioning rules in a manner not intended under the Act and Regulations.
30. For example, in the common scenario of a member who has two superannuation accounts open within the same fund (one for concessional contributions and the other for non-concessional contributions) which arguably constitutes different rights against the trustee, does this constitute one or two superannuation interests for the purposes of the proportioning rules?
31. SPAA considers that to avoid interpretation difficulties, and to reduce instances of manipulation, the concept of a “superannuation interest” requires further clarification.
32. SPAA accepts the initial intent of Income Tax Assessment Regulations 1997 (ITAR97) Regs 307-200.03 to 307.200.05 was to provide some relief to larger superannuation entities who may initially experience difficulties in identifying members as the same member in the fund. However, SPAA considers that the continued retention of these regulations now unnecessarily discriminates against SMSF in favour of other superannuation entities including Small APRA funds. Anecdotal evidence suggests that the larger funds are abusing their position so that there is no level playing field between different types of funds in this area.

## Tax treatment of exempt pension assets on death

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33. The release of the ATO’s position paper titled “Exempt current pension income” which outlines the ATO’s position on the tax treatment of exempt pension assets after death represents a significant departure from the industry’s historical understanding of the application of the law in this area.
34. Subdivision 295-F of the ITAA97 provides that income derived from fund assets which support the payment of a pension from the fund is exempt from income tax. However, questions remain about the application of this provision after the death of the pension member. In particular, it is not clear whether the income derived from pension assets after the death of the pensioner remain tax exempt or whether the relevant income is taxable from the date of death. Industry practice has for many years been based on the former position while the position adopted by the ATO in their position paper supports the latter view.
35. SPAA acknowledges that the relevant provisions of the ITAA97 and the SIS Regulations could be improved to clarify the difficulties caused by a number of interpretations. SPAA considers that eligibility for the exemption(s) provided under subdivision 295-F of the ITAA97 should be amended to ensure this exemption is correctly applied. This may or may not result in the law being applied less favourably to taxpayers.

## SMSF residency status

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36. The definition of an “Australian Superannuation Fund” in s295-95(2) of the ITAA97 is difficult for SMSF trustees and practitioners to understand and apply. The definition requires knowledge of the “central management and control test” and the “active member test” both of which can be difficult for even experienced practitioners and trustees to understand and apply.
37. A fund that fails the definition of an Australian Superannuation Fund is a non-complying fund and faces severe monetary penalties.<sup>4</sup> Furthermore, in these circumstances, the Commissioner of Taxation is not afforded discretion under s42A(5) of the SIS Act to treat the fund as a complying fund.<sup>5</sup>

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<sup>4</sup> The rate of tax payable by a trustee of a non-complying superannuation fund in respect of its taxable income of the fund is 45%.

<sup>5</sup> Because the fund is not a resident regulated superannuation fund and the requirements of SIS Act section 42(A(1)) have not been satisfied.

38. SPAA considers that in order to preserve the broad policy intent of s292-95(2), and to simplify its application, the active member test should be abolished. At the very least, the Commissioner of Taxation should be afforded discretion under section 42A(5) in situations where a fund fails the definition of an Australian Superannuation Fund in s292-95(2) of the ITAA97.

## Anti-detriment payments

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39. Section 295-485 of the ITAA97 enables the trustee of a complying superannuation fund to increase the death benefit payable to a dependent by the “tax saving amount”. This tax saving amount, commonly referred to as an “anti-detriment payment”, represents a refund of contributions tax paid by the deceased. The payment of a death benefit which has been grossed up to include a tax savings amount, entitles the fund to a tax deduction equal to the tax saving amount divided by the low tax component rate.
40. The payment of the tax saving amount must be made by the fund before the tax deduction can be claimed and which, unlike larger funds, can create significant issues for SMSFs. Those issues may result in the SMSF not having the available funds to increase a death benefit by the tax saving amount.
41. To counteract this some SMSFs establish anti-detriment reserves, and fund the tax saving amount by transferring an amount from the anti-detriment reserve. However, allocations from a fund reserve in this manner are typically counted against the member’s concessional contributions cap and this anomaly, along with the need to maintain reserves for the purposes of funding an anti-detriment payment, places SMSFs at a disadvantage when compared to larger funds.
42. SPAA considers that the anti-detriment provisions in s295-485 of the ITAA97 should be amended to ensure all funds, including SMSFs, have equal access to anti-detriment payments. This could possibly be achieved by allowing funds which are unable to fund an anti-detriment payment directly, to apply directly to the ATO for this amount. Funds which apply directly to the ATO for an anti-detriment payment would then forgo the tax deduction otherwise available under s295-485(1).

## Further Information

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We would be pleased to provide you with any further information in support of our submission.

### Contacts:

SMSF Professionals' Association of Australia Limited (SPAA)  
ACN: 103 739 617

### Address:

SPAA House  
Level 1, 366 King William St  
Adelaide SA 5000

### Contact Numbers:

Tel: (08) 8212 5999  
Facsimile: (08) 8212 5993

**Mrs. Sharyn Long**  
Chairman

**Mrs. Andrea Slattery**  
Chief Executive Officer