COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

SENATE

STANDING COMMITTEE ON ECONOMICS

Reference: Tax Laws Amendment (Simplified Superannuation) Bill 2006

TUESDAY, 30 JANUARY 2007

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SENATE STANDING COMMITTEE ON

ECONOMICS

Tuesday, 30 January 2007

Members: Senator Brandis *(Chair)*, Senator Stephens *(Deputy Chair)*, Senators Bernardi, Chapman, Joyce, Lundy, Murray and Webber

Participating members: Senators Adams, Allison, Barnett, Bartlett, Boswell, Bob Brown, George Campbell, Carr, Conroy, Eggleston, Chris Evans, Faulkner, Ferguson, Ferris, Fielding, Fifield, Forshaw, Hogg, Kirk, Lightfoot, Ludwig, Marshall, Ian Macdonald, McGauran, Mason, Milne, Nettle, O'Brien, Parry, Payne, Robert Ray, Sherry, Siewert, Watson and Wong

Senators in attendance: Senators Bernardi, Joyce, Mason, Sherry, Stephens and Webber

Terms of reference for the inquiry:

To inquire into and report on: Tax Laws Amendment (Simplified Superannuation) Bill 2006

WITNESSES

Committee met at 10.03 am

ACTING CHAIR (Senator Stephens)—Good morning. I declare open this meeting of the Senate Standing Committee on Economics. This hearing has been convened to hear evidence in relation to the Tax Laws Amendment (Simplified Superannuation) Bill 2006 and five related bills which the Senate referred to the committee on 7 December 2006. These bills implement the government's simplified superannuation reforms and rewrite superannuation taxation law into the Income Tax Assessment Act 1997. The committee is due to report to the Senate on 6 February 2007.

These are public proceedings, although the committee may agree to a request to have evidence heard in camera or may determine that certain evidence should be heard in camera. I remind all witnesses that in giving evidence to the committee they are protected by parliamentary privilege. It is unlawful for anyone to threaten or disadvantage a witness on account of evidence given to the committee, and such action may be treated by the Senate as a contempt. It is also a contempt to give false or misleading evidence to a committee. If a witness objects to answering a question, the witness should state the grounds upon which the objection is taken, and the committee will determine whether it will insist on an answer, having regard to the grounds which are claimed. If the committee determines to insist on an answer, a witness may request that the answer be given in camera, and such a request may of course also be made at any other time.

[10.05 am]

ANDERSON, Dr Michaela, Deputy Chief Executive Officer, Association of Superannuation Funds of Australia

PRAGNELL, Dr Brad, Director, Policy and Best Practice, Association of Superannuation Funds of Australia

ACTING CHAIR—I welcome our first witnesses, representatives of the Association of Superannuation Funds of Australia. Do you wish to make an opening statement?

Dr Pragnell—Yes. Thank you. The Association of Superannuation Funds of Australia, ASFA, is pleased to appear before this committee inquiry into the Tax Laws Amendment (Simplified Superannuation) Bill 2006 and five related bills. These bills introduce the government's simplified super changes announced on budget night 2006.

ASFA is a non-profit, non-political national organisation whose mission is to protect, promote and advance the interests of Australia's superannuation funds, their trustees and their members. Our members, which include corporate, public sector, industry and retail superannuation funds, account for more than 5.7 million member accounts and over 80 per cent of superannuation savings.

The matters addressed in these bills represent a major simplification of our superannuation system. The proposals will make it easier for individuals to understand the super system. In particular, the decision about when and how to access benefits should be easier to make. As a result, it should greatly assist individuals as they plan for their retirement. The package also has other benefits for individuals. It should encourage individuals to make superannuation contributions, knowing that once they reach age 60 they will ordinarily receive their benefit tax free. We are also confident that the incentives in the package will encourage individuals to withdraw their benefits in a measured fashion.

The bills also modernise parts of the existing superannuation laws by moving super tax laws from the Income Tax Assessment Act 1936 to the 1997 act. As well, the bills modernise aspects of the law by adopting the simpler drafting style of the 1997 act. While these changes are generally positive, it will take time for those who work closely with the laws to fully grasp the specific legal requirements involved.

Though modernising parts of the law and making superannuation for the individual to understand, the simplified super package does create a number of significant challenges for superannuation funds and their administrators. The use of tax file numbers, TFNs, within the package represents one such challenge. ASFA strongly supports the use of TFNs as a means of identifying fund members—in particular, to guard against members becoming lost or having unwanted multiple super accounts. It must be noted that super funds currently devote considerable time and expense to collecting and maintaining TFNs.

Where there is no TFN quoted for the member's account, the government's package will, depending on the type of contribution, prohibit its acceptance by a super fund or levy an additional tax on that contribution. This potentially exposes individual fund members to significant tax penalties, including where the employer has failed to pass the TFN on to the

fund. However, the government has indicated that it is committed to this approach and will make it work through ensuring employers pass TFNs on to super funds, providing additional resources to the ATO and undertaking a community education campaign. Given the policy path being taken by the government on TFNs, effective implementation holds the key to success.

Overall, effective implementation is critical to the success of this package, particularly with the regime commencing in slightly over five months. To date, industry consultation with the Treasury and the ATO on likely implementation issues has been very good and we are keen to work closely with the government, Treasury and the ATO to explore and develop appropriate administrative arrangements. Our written submission has clearly focused on technical issues within the bill—changes that we believe should assist in a smoother transition to the regime.

It is important to realise that it is possible some technical difficulties with the regime will not become evident until the new regime becomes operational. We should anticipate a lengthy breaking-in period, during which government, Treasury and the ATO must take a pragmatic and consultative approach with industry. As well, given the newness of the regime, and the tight time frames for implementation, we would strongly encourage a collaborative and pragmatic enforcement approach by the ATO when dealing with superannuation funds. Funds seeking to do the right thing in the first year or two of the new regime should not be subject to serious penalties due to misunderstanding of the requirements or lack of clarity. We appreciate this opportunity to appear before the committee and welcome any questions.

ACTING CHAIR—Dr Anderson, do you wish to make a statement as well?

Dr Anderson—No.

ACTING CHAIR—Thank you very much for your submission. As you say, you have addressed quite technical issues within the bill, and you have raised some important issues, I think. I want to go to the comments that you made about the implementation of the tax file number regime. Your recommendation is:

… that the provisions in Subdivision 295J be amended to prevent a fund claiming a tax offset in respect of subsequent TFN quotation for a non-member of a fund.

Does ASFA have concerns about the implementation time frame and the way in which non-tax-file-number contributors are going to be treated under the new regime? Would you like to make some comments about that?

Dr Pragnell—In terms of our specific recommendation, one thing that we have been very consistent upon is that, when a member exits a fund, effectively that should extinguish their ability to claim a refund in respect of those moneys on subsequently quoting a TFN. If that right is not somehow constrained—and it can be done in such a way that the member is making that transfer on an informed basis—then it does potentially open up some serious administrative problems for superannuation funds involved. So that is a technical aspect that we believe needs to be rectified within the bill.

More generally on the implementation of TFN issues, as I mentioned, a lot of it comes down to the effectiveness of the community education campaign that the government has indicated will be undertaken, in particular ensuring that employers are fully aware of their obligations in respect of passing TFNs on to superannuation funds. We strongly believe that

this is critical to the success of this measure. Lastly, it should be ensured that funds are able to introduce the necessary administrative requirements so that they can deal with the TFN issues and, importantly, communicate with both their members and their employers to ensure that they do get the TFNs necessary.

Dr Anderson—I think one of the keys in this is the employers. The employers passing on the TFN is a really important part of this, as well as an education campaign. It is likely that the people who will be hurt by this regime will be hurt because of the employers not being able or willing to pass on enough information to the fund, including the TFN.

Senator SHERRY—I have asked the ATO about this matter at estimates hearings. It is a matter of serious concern to the Labor Party. At the present time, the ATO estimates that 76 per cent of TFNs are held by super funds, and, according to ATO-provided data, the ATO itself holds a further seven per cent, bringing the total to 83 per cent—which means we have some 17 per cent of super fund accounts without a TFN at the present time. Firstly, on the issue of principle: the employer is required to provide the TFN of the employee at the present time, as I understand it.

Dr Pragnell—The employee actually has to tick a box on the employment declaration and opt in to give the employer authority. The employer is then required to pass on the TFN. That is the current regime. It has broken down in two respects: either the employee fails to tick the box on the employment declaration or they do tick the box on the employment declaration and for whatever reason the employer fails to pass the TFN on to the fund itself.

Senator SHERRY—So it is opt in, not opt out—is that correct?

Dr Pragnell—It is opt in, correct.

Senator SHERRY—Is it your understanding that it is proposed that opt in be changed to opt out?

Dr Pragnell—Yes. It is our understanding that it would change to there being no requirement for the individual to tick the box on the employment declaration. So that would get us over that potential hurdle. The employer would then be required to pass on the TFN. The bill indicates that quoting the TFN to the employer is taken as quoting the TFN to the fund. The employer is effectively required to pass those TFNs on to the funds.

Senator SHERRY—Can we assume that there will be X percentage—we do not know how many—that will not be passed on by an employer for whatever reason?

Dr Pragnell—Yes.

Dr Anderson—It is just that policing the whole thing will be rather difficult.

Senator SHERRY—I accept it will be difficult to police. As a matter of principle, if the employer fails that revamped legal responsibility in a compulsory system where there will be a whole range of issues around inertia, failure to notify address et cetera, why should the employee face a massive tax penalty on their contributions—an increase from 15 per cent to 46.5 per cent?

Dr Pragnell—In terms of the policing issue, there are a few other things happening as well. One is that the enforcement of the TFN requirements placed on employers will be

shifted from APRA to the ATO. I think that the ATO has, particularly around the superannuation guarantee, a reasonably good track record in terms of ensuring an acceptable level of employer compliance. I think we are hopeful that the ATO will take a much more rigorous enforcement approach and will better ensure that employers meet their legal obligations, and that those funds will get those TFNs that they need so that those members are not subject to that tax penalty.

Senator SHERRY—I guess, but my question was: if the employer fails to pass on the TFN, why should the member, through no fault of their own, have to pay the penalty, which has massively increased from 15 per cent to 46.5 per cent?

Dr Anderson—I think, as a matter of principle, you are quite correct: if it has not been passed on then that does not seem right.

Senator MASON—It assumes that the employee has passed the information on. You cannot always assume that.

Senator SHERRY—The employer will have the tax file number for other reasons and they are going to be required to pass it on.

Senator MASON—In that case, all right.

Senator SHERRY—Let us assume there is going to be an X level of failure to pass on—we do not know what it is going to be. I would be confident that you could reduce the current 17 per cent non-provision to five per cent. If the figure is five per cent—let us say there is a dramatic reduction in the non-provision of tax file numbers by employers—of a workforce of 10 million, that is still half a million people who would be subject to a higher tax regime.

Dr Anderson—If in fact they have provided the tax file number to the employer, it does seem a lot of people would be subject to the regime of higher tax.

Senator SHERRY—My understanding is that these people can at some future date—I think there is a time limit—reclaim the tax that has been paid.

Dr Pragnell—Correct.

Senator SHERRY—The suggestion you are making goes to the practicality, from the fund's point of view.

Dr Pragnell—Yes.

Dr Anderson—But only at the point where the member is leaving the fund. That is the point. When the member is exiting the fund, we see the fund having an opportunity to actually speak to the member and inform them of the fact that they are going to need to give their tax file number or extra tax would not be able to be claimed back. To actually allow them to claim it back from a fund that they have already exited would be really quite horrendous. All we are saying is that, at that point, the member would have to make a conscious decision that they are not giving their tax file number, knowing everything that was likely to follow, and then the administrative nightmare would not occur because they could not claim it later.

Senator SHERRY—But isn't there a practical issue here? I am sure you are aware, as I think we all are, that funds constantly provide forms for all manner of things—updating

addresses, next of kin, tax file numbers, exercising portability—and there is unfortunately a level of inertia failure. A proportion of people just do not do it, do they?

Dr Anderson—But, if the person is moving from the fund and you actually say to them straight out, 'You're going to incur more tax if you don't at this point hand over your tax file number,' I think you've got to say that you've done everything you can. The person says, 'No, I'm not going to hand it over,' in a lot of cases. If inertia is that prevalent when people are actually moving their funds, I think we have got a real problem and tax file numbers are the least of our worries.

Dr Pragnell—On this issue as well: if it is going to work, it does require a multipronged approach. The other thing that should be looked at is whether or not the ATO can take a more active role, in terms of passing TFNs on to funds. Whether that requires a member providing consent or whether the ATO can do it off its own bat obviously raises issues around privacy and TFNs. But, if the ATO is given greater ability, once it has identified a member, to give the TFN to the fund, then that will address a number of problems as well. That will be part of lifting that percentage of quotation up a little bit further, hopefully.

Senator SHERRY—IFSA have suggested, I think, that this issue be deferred for implementation for a year because of the administration of transition and information and attempts to maximise the collection of TFNs and minimise the problems around this. Does AFSA support IFSA's call to defer the implementation of this for one year?

Dr Anderson—With five months to go, I think we would look quite favourably at any deferring, because there is a lot to do if you are going to get that 17 per cent in there.

Senator BERNARDI—With regard to the tax file number issue: after someone establishes an account with one of your members, is it general practice to communicate with the account holder requesting any outstanding information if it has not been supplied by the employer? I think we have to accept that some employers are not as diligent in providing information, but they have the opportunity, immediately after establishing an account, to provide the tax file number. Is that right?

Dr Anderson—If the employer has provided enough information so that they can in fact contact the member, yes, it would generally be so.

Senator BERNARDI—So you have circumstances where you do not even have the contact details of some of your members?

Dr Anderson—That would be so.

Senator BERNARDI—Does that occur often?

Dr Anderson—When you are looking at contract workers or people who are moving around, it is quite likely that you have lost them before you have actually sent a letter out welcoming them to the fund.

Senator BERNARDI—And that is when it goes into the lost superannuation list; is that right?

Dr Anderson—It is where the trouble starts. If we could actually get employers to hand on the tax file number, there is no doubt that a lot of the lost members would be there. It would just be an easier way of tracking people.

Senator BERNARDI—There are always going to be some exceptions but in the main people do have the opportunity to redress any of these issues themselves.

Dr Anderson—Funds do try—

Senator BERNARDI—Yes, they do try.

Dr Anderson—very hard to get proper information. Funds do not like having lost members. It is not good on a number of grounds, one of them being administrative difficulties.

Senator BERNARDI—Can I go to this issue of reclaiming of moneys when they have left the fund. I make the assumption that you remit the additional tax to the Australian Taxation Office; is that right?

Dr Anderson—Yes.

Senator BERNARDI—Would it be your suggestion that anyone who leaves a fund should then provide a tax file number and seek that additional taxation—that, rather than dealing with the fund directly, they should pursue that through the Taxation Office?

Dr Anderson—It would be one option, yes.

Senator BERNARDI—That would remove the compliance burden from the fund.

Dr Pragnell—Yes.

Senator BERNARDI—And they could pursue that in the normal course of events through their tax return or an appropriate mechanism.

Dr Pragnell—Yes. There are other ways that that can be addressed, just as you are proposing.

Senator SHERRY—At the moment there are about 5.7 million lost accounts containing close to $10 billion, aren't there?

Dr Pragnell—Yes.

Senator SHERRY—And that is with the best efforts of funds to try to reduce the lost member accounts by seeking information to minimise the number. That is correct, isn't it?

Dr Anderson—Definitional issues would mean there may not be as many lost—

Dr Pragnell—Yes, it depends on how you define that.

Senator SHERRY—Sure. A lost member is where it is returned 'address unknown' after two years; there have been no contributions for two years; and there may be some active lost members. I would accept that, but there is a problem in this area regarding getting the information, isn't there?

Dr Anderson—I think there is big problem.

Senator SHERRY—Are you aware that the REST superannuation fund—which is retailed at lower income, casual, constant movement—provided some figures to the corps and

financial services committee on the efforts they went to to get tax file numbers. Given the nature of the workforce it was a very low response, despite a highly proactive campaign—I suspect in preparation for this. Are you aware of that?

Dr Anderson—Yes. It says, to me at least, that if you have a compulsory system where people, particularly in a workforce that is moving around a lot, are not as engaged with the system, you really are relying on the employers yet again. If employers, for employment purposes, have to get TFN, it seems to me that we could in fact make a big jump here, as long as we do it carefully, not too quickly and protect people along the way while we put it in proper order. It seems to me this is something that should have happened when we started the compulsory system.

Senator JOYCE—Haven't people got some period of time in which to provide their tax file numbers—30 days or something like that—after they start work? I am thinking of that figure of over $10 billion, and there are a number of questions. Itinerant workers, for instance, who, to be completely frank, might be dodging the system—they might even be from this country—have 30 days to provide tax file numbers, so they will come up with a number, 123456789, just before they leave to go somewhere else. That is just the reality of an economy. How are you going to do this—carry a big stick and try to beat it out of them? Of that $10 billion, is there a segment there that is just written off in perpetuity? It has been there; it will probably never be collected. The people who put the money in have no intention of collecting it. It has been there for 15 years. It is from periods of work less than 30 days. Is there any breakdown of that amount?

Dr Anderson—I think there is some breakdown, which we do not have here, but you are right in that there would be some like that. We know that there are fictitious names that seem to go with people—

Senator JOYCE—Johnnie Walker and Jim Beam would have a lot of super!

Dr Anderson—There was a footballer one year who also seemed to have a lot.

Senator SHERRY—So do Elvis Presley and George Bush, apparently!

Dr Pragnell—And also many people with 1 January 1960 as a birth date and some employers and some funds.

Senator JOYCE—In the quest to find these people, they do exist but they have no intention nor were they ever really wishing to be part of the system. Do we have any breakdown that shows that that $10 billion actually belongs to that—

Senator SHERRY—I think the ATO has some data.

Dr Anderson—I think we do have a bit of an estimate. But I think we also know that that is a part of that $10 billion. Another part is not really lost, but there is a considerable amount that is just waiting there and could be attached to a person.

Senator JOYCE—The rest is mine!

Senator BERNARDI—Senator Joyce has touched on an important point: how many of these accounts are old accounts that were introduced or are essentially non-active under a perhaps less rigorous compliance regime? Senator Sherry said about 17 per cent of super

funds are not holding tax file numbers. I wonder what percentage of new superannuation accounts are established without tax file numbers being provided in a timely manner?

Dr Anderson—We do know that that is still happening. Non-quotation of tax file numbers by employers is not something that used to be part of the practice in the old days but is not anymore. We know that it is still not being passed on by employers.

Senator BERNARDI—If 100 new accounts are established, what would be the percentage of new accounts that would not have a tax file number supplied either immediately by the employer or within a reasonable time frame of 60 days or thereabouts?

Dr Anderson—I think you would have to look at the figures given by REST to see that.

Senator BERNARDI—You do not have them to hand, do you?

Dr Anderson—We do not have them to hand, but they do suggest to me, at least, that the practice in that particular workforce of not handing on the tax file numbers is, to some degree, still continuing.

Senator BERNARDI—In your experience is this practice more prevalent in the retail industry versus other industries?

Dr Anderson—It tends to occur more where you have more casual part-time workers. It does not always appear to be just small business. It is actually much more widespread, which surprised me.

Senator SHERRY—I asked the tax office and the Treasury about this matter. I asked them: when a refund is paid to a member paying higher contributions tax would there be a lost interest component. I do not want to misquote them, but they were not sure at that point. Should a lost interest component, perhaps at the long-term government bond rate, be included in the refund of the tax?

Senator JOYCE—There is.

Dr Pragnell—There is an interest component in the bill in respect of certain circumstances being met where the employer has failed to do certain things. Currently, it is in the bill, so there is a lost interest component in there.

Senator SHERRY—Good.

ACTING CHAIR—I think that is all on that particular matter, but I want to now go to the recommendation that you make in your submission in relation to adjusting transitional contribution limits. Could you elaborate on that recommendation? I think that is quite a significant issue that you have detected.

Dr Pragnell—One issue that, as you noted, was in our submission was that the government has agreed to index the concessional contribution limit on a ratchet basis, looking at indexing in $5,000 lots. So it would go from $50,000 to $55,000 and then to $60,000. The non-concessional contribution limit would remain at three times that amount so that when the concessional contribution limit goes from $50,000 to $55,000, the non-concessional contribution would go from $150,000 to $165,000. There is a bit of simple math in there. The non-concessional contribution limit stays at three times the concessional limit.

The transitional contribution limit for persons who turn 50 in a particular year is currently, or is proposed to be, $100,000. One way that you could look at that, on the basis of simplicity, is that it is two times the concessional contribution limits. We are proposing that, when the concessional contribution limit is adjusted upwards from, say, $50,000 to $55,000, the transitional goes from $100,000 to $110,000. On one basis, we feel that this addresses an issue of complexity by keeping it at simple math—times two and times three—and it keeps it simple on that basis.

ACTING CHAIR—Did you raise this issue in your consultations with government?

Dr Pragnell—We raised the issue generally of indexation of the contribution limits during the consultation period. We were very supportive of indexation of the limits. We did not suggest the ratchet approach that was eventually adopted, so we are quite pleased that both the concessional and the non-concessional limits will be indexed accordingly. Again, to keep everything simple, we would like to see the transitional contribution limits similarly adjusted as well.

Senator BERNARDI—In your experience, if people are making a significant contribution to superannuation, do they generally seek professional advice before doing so—from a financial adviser, from a financial planner or from their accountant?

Dr Anderson—If it is significant.

Dr Pragnell—If it is significant, yes.

Senator BERNARDI—I understand what you are saying about confusion of transitional limits, but if that were the case and they were seeking advice on this matter, a professional adviser would be able to give them that information according to the current indexation regime, wouldn't they?

Dr Pragnell—We are dealing with the concessional contribution limits. So you are also looking at the issue of where persons are looking at, say, salary sacrificing certain amounts. So you are looking at persons who turn 50 in a particular year, who may have their mind really focused on their superannuation and who may be just dealing directly with their employer in respect of salary sacrificing to build up their superannuation at that point. That person may be getting professional advice but they may not be. They may just be dealing directly with their employer. They may be dealing directly with a human resource manager as well. So, for those types of individuals, I think that keeping it simple probably assists them in terms of planning and going forward.

Senator BERNARDI—I recognise keeping it simple, but for people to find out at the start of a year whether it is two times the current level or a specified amount is a pretty simple process, wherever it is. They would simply have to go to the same information site to establish what they could do. They have to know one figure in order to calculate the other, so what is the difference in just saying, 'This is the figure you are allowed to do this year'? I take your point about simplicity, but I make that observation.

Senator SHERRY—I have a follow-up issue on the same matter. I thought that one of the objectives of this was that people would not go to planners. In fact, the Treasurer trumpeted in triumphant fashion that massive amounts of money were going to be saved as a consequence

of this legislation, because people would not be going to planners rather than the reverse. That is true, isn't it?

Dr Anderson—You would hope so, but in fact—

Senator SHERRY—You would hope so, yes.

Senator BERNARDI—I understand what Senator Sherry is saying, but the Treasurer was specifically talking about the redemption of funds in a pension environment because of the previous historical compliance regimes with pensions and allocated pensions and fulfilling actuarial tables and statistics. It was not about making contributions, to my knowledge, anyway.

Senator SHERRY—I do not think it was, but that is a debating point. One related issue that has not received any attention concerns the new higher contribution limits, and it is not in any of the submissions. If a person is in a defined benefit fund—and I have had this raised with me by a number of people, colleagues in particular—would a person have to go to their existing defined benefit fund where they are an active member to get advice from the fund about what the value of their current contribution is if they want to make additional contributions in order to ensure that they are within the new limits?

Dr Pragnell—Our understanding is that the notional contributions for DBs are going to be dealt with in forthcoming regulations. We and, I think, many other people have raised the issue that the member will need to know at the beginning of the year to be able to make decisions rather than when a number spits out at the end of the year. I agree. That is a point that we have been raising. We are aware that regulations on that are being worked on at the moment.

Senator JOYCE—Do you think there is an unnecessary crossover at times between accountants and financial planners? As an accountant it used to be the bane of my disaffection that we would spend 10 or 15 years becoming qualified and getting postgraduate qualifications, then apparently we are not allowed to tell someone to basically do a glorified form of putting their money into the bank.

Senator BERNARDI—I think we should have an in camera discussion about that!

Senator JOYCE—Do you think there is room for greater latitude to be given to accountants, taking on board their obvious competency in dealing with people's money and seeing that they deal with every other section of the person's money?

Dr Anderson—It is a difficult question to answer. I think there is particular expertise that is needed, perhaps, that not all accountants have. I have noticed that some accountants are reluctant to give certain investment advice unless they have undergone qualifications other than the normal run-of-the-mill accountancy ones because there are differences perhaps with investing.

Senator JOYCE—Do you think that in latter years there has been an unnecessary tie-up of accountants as they start going into certain areas—saying, 'You shall not talk on this; you shall not talk on that,'—or areas where they formerly talked quite freely without necessarily causing a huge amount of hurt? When you think of the comparable weight that a real estate

agent has to advise you to buy a house, which is a major investment, do you think that that sort of latitude or loosening of the strings on accountants should be brought into place?

Dr Pragnell—I think, generally, the whole issue of the advice regime around FSR is something that we have all been dealing with. It is not just accountants; it is employers, it is superannuation funds—a lot of other people have been caught in the broad net of how financial product advice is defined. In other forums, particularly in the Parliamentary Joint Committee on Corporations and Financial Services and also in our consultations with Treasury on the FSR refinements, we have been proposing that the government consider looking at how financial product advice is defined and possibly narrowing that definition in such a way that it would capture the type of advice that it probably was intended to capture and not be so broad that it captures other types of communications that probably were acceptable in the past in which there is probably minimal if any mischief potentially involved and really try to focus on particular types of interactions where, effectively, specific products are being recommended.

Senator JOYCE—That is good to hear.

ACTING CHAIR—Thank you, Dr Pragnell. There are some issues that were raised in other submissions that I wanted to pursue with you. Before I do, Senator Mason has a question about compliance.

Senator MASON—In reply to a question from, I think, Senator Sherry, about the implementation of this legislation you said that, given its complexity, the government may wish to hold back from 1 July and delay implementation. Is that right?

Dr Anderson—I think we were talking about tax file numbers.

Senator MASON—Okay, it was that part. You mentioned in your submission that there should be a pragmatic and consultative approach in terms of enforcement. Dr Pragnell, is that because you are worried that people will not be able to get on top of this legislation in time? Is that what you are worried about?

Dr Pragnell—I think it is more about funds having to interpret the legislation, which is new legislation, having to make decisions and then having to effectively administer that and deal with the ATO—particularly providers. Superannuation funds and their administrators are trying to introduce system changes at the moment, and we are still dealing with the bill, we are still getting regs and draft regs coming out. It is hard because they have to implement changes on the run and have to make assumptions, that they think X means this and therefore they are going to have to introduce this new procedure. I think that is more where the challenges are coming from for funds and their administrators.

Senator MASON—The legislation has not passed and we have, what, five months before—

Dr Anderson—Exactly.

Dr Pragnell—That is right. We still have a bill, we still have regs. It was always going to be a challenge, and I think Treasury did a very admirable job in terms of the consultation process and in terms of what we thought at the time was a very quick turnaround. But it was always going to be a really tough call to get all of this up and running by 1 July 2007.

Dr Anderson—One of the things we have mentioned too is that, because of the time frame and because we are still getting regulations and looking at policy, I do not think we are aware of every little wrinkle that is going to be there when it actually starts.

Senator MASON—I am sure you are right.

Dr Anderson—And, with this sort of rush to the end, I think we are going to need some leniency in the way it is enforced—which is not to say that you don't enforce it, but I think you're going to have to look pragmatically at what happens if you hit something like that.

Senator MASON—I understand—some forbearance from the ATO. Good luck!

ACTING CHAIR—Thank you, Senator Mason. Going to some of the other submissions in the short time we have left, one of the issues raised is around possible inequities in the different treatment of dependants and nondependants when calculating taxes on superannuation death benefits. Do you have any comments to make about that aspect of the bill?

Dr Anderson—In our original submission to Treasury we looked at this. We think that if a person dies at or after the age of 60 it should be tax exempt if paid to anybody after that time. We are in agreement with some of the submissions in this area. But in this current submission we were looking mostly at technical issues rather than at policy. If you have different tax treatments, there is quite a lot of getting around it, and that does not seem to be good if we are trying to implement simplicity.

Senator SHERRY—Is this the death tax issue that has been commented on in the *Financial Review*?

Dr Anderson—Yes.

Senator SHERRY—Is there any change, though, in the proposed legislation from the existing regime in terms of tax treatment on death?

Dr Anderson—No, but there is a difference in that you will be paying the tax after age 60.

Senator SHERRY—They are still paying death tax effectively, though. If they die before they collect the money, it goes to the estate and it is taxed on entry to the estate.

Dr Anderson—Yes.

Dr Pragnell—At the moment you pay tax on the basis of whether or not it is received by a dependant or a nondependant—there are different tax treatments at the moment—so that principle carries through. But with the new proposals we have had a new overlay. We have had an introduction where you take a benefit post age 60 and it is tax free. That means we maintain a differentiation between dependant and nondependant, and it creates some interesting strategies where it is more tax advantageous for a person to turn 60, withdraw their benefit, pay no tax and then distribute it to nondependants. There is nothing to prevent that. But if you keep it in the fund, turn 60 and get hit by a bus and have no dependants, the moneys paid to nondependants will be taxed. The issue is more that there is an overlay of the tax-free situation for 60 and over.

Dr Anderson—Some of the best case studies of this are in the Mercer submission, where they go through different scenarios. When you read those, you can see that it is probably not

where we would like to be, with people trying to organise to not pay tax—not having the opportunity in some cases but having the opportunity in others.

Senator SHERRY—For example, a terminally ill person with cancer who knows they are going to die would presumably have the opportunity, because of the advance knowledge, to arrange their affairs not to pay the tax, whereas the estate of a person hit by a bus would be taxed if left to a nondependant.

Dr Pragnell—That is correct. You then end up with strategies arising out of that. There are also administrative issues for funds around that in terms of when a member turns 60 and they are going to have to make a determination about dependent or nondependent recipients, whereas if it is paid out to a member post 60 no tax is paid. There are a number of levels where it creates some interesting outcomes.

ACTING CHAIR—Several of those scenarios have been outlined in submissions, and they raise some quite interesting questions. An issue was raised by AXA in their submission, which relates to the issue of trustee contributions. The possibility for trustees to make contributions on behalf of members without being subject to contribution tax has been omitted from this bill whereas it exists in the current legislation. Were you aware of that? Is that an issue that might be of concern to your membership?

Dr Pragnell—We read through a number of the submissions but we did not read the AXA submission, so we can review that and have a think about it.

ACTING CHAIR—That would be very helpful. There being no further questions, thank you very much for your time this morning and for your submission; it has been very helpful in getting our heads around this very complicated simplified superannuation bill.

[10.56 am]

BRADY, Ms Helen, MLC Technical Services (Manager, Industry Liaison), Investment and Financial Services Association

LEE, Miss Stephanie, Senior Policy Manager, Investment and Financial Services Association

O'SHAUGHNESSY, Mr John, Deputy Chief Executive Officer, Investment and Financial Services Association

ACTING CHAIR—I welcome the representatives of the Investment and Financial Services Association. Mr O'Shaughnessy, do you wish to make an opening statement?

Mr O'Shaughnessy—Yes. IFSA wishes to thank the committee for the opportunity to contribute to the committee's inquiry into the Tax Laws Amendment (Simplified Superannuation) Bill 2006 and five related bills. IFSA is a national not-for-profit organisation which represents the retail and wholesale funds management, superannuation and life insurance industries. IFSA has over 140 members, who are responsible for investing over $950 billion on behalf of more than nine million Australians. Members' compliance with IFSA standards and guidance notes ensures the promotion of industry best practice.

IFSA welcomes this package of legislation. The measures contained in it will significantly reduce complexity for the majority of consumers and result in an Australian superannuation system that is much simpler and more effective. This is an outstanding result that positions Australia as a world leader and creates an even more attractive environment in which people can save for their retirement.

The government and the Treasury are to be congratulated on the package, and particularly on the consultation process leading to the development of this legislation. Since the plan was originally announced by the Treasurer, the Hon. Peter Costello, only in May 2006, Treasury's efforts to engage with industry in a necessarily compressed time frame are appreciated, and we are pleased to see that most of the core concerns have been addressed in the legislation. IFSA welcomes the announcement in December by the shadow minister for superannuation and intergenerational finance, banking and financial services, the Hon. Nick Sherry, of bipartisan support for this important legislative package. Given that most of these measures will commence on 1 July 2007, with some measures having already commenced, IFSA believes that it is of critical importance that the bill is assured of a smooth passage through parliament. Stability and certainty in the Australian superannuation system are absolutely critical for consumers. Industry and the broader community will not have reasonable certainty until the bill is enacted and supporting regulations have been made.

In our submission to this committee, IFSA raised three key issues which we believe should be addressed in the legislation. The issues raised are primarily mechanical and procedural in nature and will assist industry and consumers in the short term in the transition to the new regime. However, despite putting forward these recommendations, we believe that it is paramount that the bill's passage should not be delayed.

Before delving into the specific IFSA recommendations, I note that it is inevitable, given the scope and size of the bill and the tight time frames available, that some issues of a very technical nature will arise and will continue to arise as the new regime is bedded down. We have raised and continue to raise these issues directly with Treasury, with a view to having them addressed in the consequential amendments.

I will now briefly outline the three recommendations that IFSA would like to put forward today for the committee's consideration. The first is on the nonquotation of tax file numbers. IFSA proposes some refinements to the TFN quotation measures. We ask that the committee note IFSA's understanding that the TFN measures are a key mechanism for ensuring the integrity of the new contribution cap regime and to improve procedures for locating lost members. Our preference was that the consequences for failure to provide a TFN rest with the responsible member. However, in the context of the current provisions, which impose liability on funds, we believe that, given that the measures are among the more significant in terms of changes to the systems and processes, some relief from the stricter long-term standard is required. We also note that there is little time for the ATO and the industry to run effective awareness campaigns aimed at improving TFN quotation levels in the lead-up to the commencement of these changes. This may result in a large number of members being inadvertently caught by the new provisions requiring either rejection of personal type contributions or the imposition of the higher tax on employer type contributions at the rate of 46.5 per cent.

In addition, IFSA members have identified a number of difficulties that relate to the process of rejecting non-concessional contributions, applying the non-TFN tax and claiming the refunds of the non-TFN tax. We have devised various options for consideration which might operate as a package or on a stand-alone basis. These include a 12-month delay to the commencement of the measures to allow sufficient time for the ATO and the funds to run effective awareness campaigns enabling the establishment of a robust regime for the collection and administration of TFNs. They also include allowing the option of refunding personal type contributions within a specific time frame rather than rejecting them outright. This would assist funds that may have problems rejecting contributions, particularly where they are made via interposed entities such as payroll providers or clearing houses. The options also include a three-month gap after the end of the financial year before funds are required to collect non-TFN tax, in order to accommodate late quotations. This would allow most funds time to make appropriate adjustments before returns become due.

The second matter covers the flexibility in crystallising tax components for legacy products. IFSA proposes that there should be some flexibility in the time at which funds are required to crystallise members' tax components to cater for certain legacy products where they are no longer being offered to new clients. The bill currently requires funds to determine the value of the pre-1983 component of everyone's superannuation benefit as at 30 June 2007. The value will need to be crystallised, therefore, by 30 June 2008. While we welcome the benefits in terms of simplification that result from reducing the number of tax components of superannuation from benefits from eight down to two, there are potentially systems and costs issues for closed or legacy superannuation products. This is primarily because the information required to perform these calculations is either paper based or held on imaging systems and

will need to be retrieved and calculated manually. As such, a number of superannuation providers only calculate the components upon member inquiry or benefit payment.

IFSA proposes that closed superannuation products that were closed on 1 July 2006 be given the flexibility to crystallise the pre-1983 component at a latter point in time—say, within a three-year time frame—when a certain event is triggered, but still holding the value as at 30 June 2007—for example, when a member exits the fund or inquires as to the breakdown of the tax component. Importantly, we do not believe that this will compromise the intent of the legislation, nor will members be adversely impacted.

The last point is to do with the time frames for the payment of excess contributions tax. We propose an amendment that would resolve the mismatch between the time period in which excess contributions tax is payable—21 days—and the time frame for a fund to action a release authority, which is 30 days. The mismatch could mean members are subject to penalty by way of a general interest charge for not remitting the tax on time, due to a misunderstanding of the time frame available to the fund as opposed to the time frame in which they are liable to remit the tax.

The issue is particularly important with regard to the payment of tax on excess non-concessional contributions where there is a mandatory requirement to withdraw the amount from the fund. IFSA suggests that this issue could be overcome by extending the tax payment period from 21 days to around 50 or 60 days, approximately the sum of the member's and the fund's payment periods. The member would be given a maximum of 21 or, ideally, 30 days in which to ensure that they lodge the release authority from the fund. It is our view that this will assist members to meet their tax liability on time and reduce ATO follow-ups.

In conclusion: as noted at the outset, the recommendations we have made to the committee are designed to improve some of the mechanical aspects of the reforms. They are not designed to alter the intent of the legislation and we ask the committee to give them every possible consideration. I would also stress that IFSA's concern is to ensure the bill is granted swift passage to enable supporting regulations to be made and to provide maximum certainty to the industry and the broader community in the lead-up to the implementation of these reforms.

ACTING CHAIR—Thank you. Miss Lee, do you wish to make any additional comments?

Miss Lee—No. That is fine, thank you.

ACTING CHAIR—I am sure you heard the discussion that we had with our previous witnesses about the tax file number problems and perhaps having additional time for that part of the legislation to be considered. We might try and pursue some other issues first and then come back to that.

Senator SHERRY—I am happy to put aside the TFN discussion. I think we canvassed it well with AFSA, and IFSA seem to have similar, if not the same, views. On the crystallisation of benefits, the suggestion you have made seems to me, on the face of it, to be appropriate, common-sense and practical. Are there any implications for government revenue, in terms of loss of revenue, if such an approach is taken?

Miss Lee—We do not believe there will be any revenue implications, given that we are proposing that the crystallisation simply be delayed until a certain trigger event happens. The

member may choose to exit the fund or cash out their benefits, at which point the component would be crystallised, but it would be crystallised with reference to the value of that component at 30 June 2007, which is the same as is proposed currently in the bill.

Senator SHERRY—It would depend on the fund, I suppose, but certainly for some providers there would be significant administrative, practical issues, that were referred to in the opening address, about implementation if there were not a more flexible approach taken on this matter.

Miss Lee—We are only seeking flexibility for these types of closed products. For products that are open to new members, we are happy with the one-year time frame that is currently proposed in the bill, up until 30 June 2008. It is really only for these closed products where these sorts of calculations are done on a manual basis where it can be quite onerous and potentially quite costly.

Senator SHERRY—Presumably the overwhelming majority of members currently in the system would not be affected by this anyway. You are dealing with a relatively small number. Can you give me any idea of the number—is it in the hundreds of thousands?

Miss Lee—I cannot, I am sorry.

Mr O'Shaughnessy—It is going to be quite small. I know that it is going to be somewhere south of about three per cent of Australians, much less than three per cent.

Senator SHERRY—I want to raise an issue which you have not touched on but that I have had a quite a lot of correspondence about: the issue of overseas transfers. I am using the UK by example because there tend to be a lot of former UK residents moving to Australia and, to varying degrees, transferring money in. My understanding is that they would only be able to transfer in in each year up to the contribution caps that are proposed. Is that correct?

Miss Lee—That is correct, yes.

Senator SHERRY—The people who have written to me, both practitioners and individuals, have pointed out the difficulty this poses if you have moneys that you wish to transfer in, say, from the UK. You simply cannot transfer the moneys in. That then has a flow-on. They are effectively operating in two jurisdictions: the UK, from where moneys are being paid to them in Australia, and with moneys they have transferred in to Australia, which adds to complexity. Have you given this issue any thought?

Mr O'Shaughnessy—We have. I will get Miss Lee to talk about that.

Miss Lee—We have given this issue some thought. In our submission which we put in during the Treasurer's consultation period in August we proposed that transfers from overseas be exempt from the contribution limits. However, we recognise that there would be a need, if such a proposal were accepted, for antiavoidance measures to prevent people from intentionally setting up an overseas fund in order to circumvent the contribution limits. We also consider that most transfers from overseas should fall within the contribution limits that are proposed, but we believe that it may be possible for Treasury, in conjunction with industry, to develop an acceptable solution. But, as this could take some time due to the need for these antiavoidance measures, it may have to be addressed at a later stage, perhaps in a final round-up of technical issues. As we mentioned at the outset, I think IFSA's main concern

is that the bill is passed as swiftly as possible, and we would not want an issue such as this one to delay passage.

Senator SHERRY—I agree with that approach but, for example, in the case of the UK, where the people have never been resident in Australia and effectively retire here, my understanding is that you have either all or nothing; you transfer it all out of the country or you have to just transfer it out of the fund on a gradual basis, and there are some significant tax implications for the individuals in these circumstances. I appreciate the complexity, because you have to look at it jurisdiction by jurisdiction, but the UK is the one that has been drawn to my attention as the most likely, given the numbers of people who come here post retirement. So you are suggesting that the issue needs further consideration, case by case, on antiavoidance. That is effectively what you want to look at—

Miss Lee—Yes, that is right.

Senator SHERRY—On the antiavoidance issue, is it correct—and I have had this drawn to my attention by an Australian resident in the UK—that an Australian person who is resident in the UK and paying income tax in the UK can make contributions from the UK into the Australian system in some circumstances?

Miss Lee—I do not know. You would have to ask Helen.

Ms Brady—It is potentially possible, but we do not offer our products in other jurisdictions. So they would have to, in general terms, have taken out that product or interest whilst in Australia because we do not offer products in jurisdictions unless we can comply with those laws. Complying with Australian law is hard enough, so that is not usually the case. But if a person is a member and they meet other requirements, I do not believe that there is an impediment to their ongoing supplementation of an interest that they have in an Australian fund.

Senator SHERRY—It just struck me as a little odd that if you were in the UK paying UK tax and contributing under UK law to their pension system—which is not a tax system pre retirement; it is post retirement—you could at the same time contribute to the Australian system if you were a member of a fund here.

Ms Brady—In the majority of cases, those people would have been residents of Australia at some point. That is not always the case; there are ways that people can get around that if they travel to Australia a lot. But we have a lot of people who have become expats and then come back to Australia, so I do not know that we would want to make that distinction. We do believe that this needs to be addressed, but Treasury has raised, and we have heard of, significant and widespread strategies to set up overseas funds to specifically circumvent the caps by rolling in amounts. So it is quite a complex thing to address and get a reasonable solution to to cover legitimate circumstances. We would certainly like to work with the rest of the industry, the accounting profession, which has a lot to do with these, and try to devise something that is reasonable. I am just not sure that we can come up with that in the next months before the bill goes through.

Senator SHERRY—Yes. When I raised this issue with Treasury, the response was that it was complex and they were looking at it but it would need further examination.

Ms Brady—And we definitely agree with that. We would not want to see people being completely cut out of the system. I am just not quite sure how we deal with the very legitimate arrangements—whether we have another cap or something, I do not know.

Senator SHERRY—There is just one other issue, which has really had very little attention in this debate and is not mentioned in submissions but which I anticipate is going to be much more of an issue—that is, when a member draws down from their account, the interaction with the assets and income test of the age pension. An individual can draw down any quantum of income from their super account at age 60, subject to the minimum draw-down factors. Wouldn't that mean that there would be an increasing administrative issue around the provision of their income draw-down for the purposes of the assets and income test? The individual is going to have to provide details of the draw-down, both the income and the asset residue that is left in their account, to the department for the purposes of the assets and income test, aren't they?

Mr O'Shaughnessy—I think it has certainly been discussed.

Miss Lee—We are probably not in the best position to comment on social security aspects today. There has been some detail released on social security changes but a lot of further detail is yet to come, so we are not really sure yet how the process is going to work.

Senator SHERRY—Yes. Just on this, though: will it be the individual who is required to pass the information on to the department for the purposes of the assets and income test and/or will the fund have any requirement to pass such information on?

Miss Lee—I think we would expect it to be a bit of both, but I might ask Helen if she can add to that.

Ms Brady—Currently, with allocated pensions, which is what the new minimum pensions are similar to without the maximum—we provide biannual reports for this purpose to the member—there is a project being run by FaCSIA and others—I think there are three areas that have to work on this—to automate the transmission of information. Again, that is an issue that we need to manage in the context of the significant changes that are occurring within the industry. But it currently works for allocated pensions. So we really are waiting on the detail to see exactly what changes will be required, because that will mean that our schedules of information may have to change.

Senator SHERRY—Yes.

Ms Brady—So again it is a timing and implementation management issue.

Senator SHERRY—It just seems to me that, given increasing super balances, increasing numbers of people with increasing quantums of savings that would be affected by the assets and income test, it is going to be necessary to have robust systems in place to deal with what will be constantly changing payments of the age pension to individuals who are entitled to a part pension—and they would be significant in number, I would think.

Ms Brady—Potentially. Our current experience—and I do not have industry figures—with allocated pensions is that the vast majority draw at the minimum level; they do not tend to go up to the maximum. So I am not sure how much fluctuation will occur there. Again that is something behavioural that we may need to look at. But I think that FaCSIA and DVA can

also get information from the tax office if there is a fear that there is a lack of reporting or there is inappropriate disclosure. I do think you are right that over time there is going to have to be a standard systems approach to passing on that information. We would very much like that to not be a replica of the data and the processes we have to go through with the ATO and then social security or FaCSIA or different departments, which would be costly.

Senator BERNARDI—Firstly, may I say that your considered submission, your support for this legislation and the assessment that some of the issues that you raise should not delay the passage of this legislation I think is a very sensible approach. I do have a couple of minor questions in regard to that. In your submission you said that, if there is a contribution made by one of your policyholders, you are not able to accept it if the tax file number—we are back on the tax file numbers again—is not on record. What is the standard process? Do you say, 'We can't accept your contribution for this reason,' and then once again it goes back to being the employee's or policyholder's responsibility?

Mr O'Shaughnessy—The way it stands at the moment is that it is rejected, but I will hand over to Miss Lee to answer that.

Miss Lee—Currently I think funds can accept post-tax or personal contributions if there is no TFN. The new requirement to reject these contributions comes into effect on 1 July. Part of IFSA's proposal is to allow a three-month grace period, which would allow the fund to accept the contribution and then potentially issue some form of communication to the member in an attempt to obtain the TFN before it gets to the point where they have to reject the contribution. We think that would help administratively with some of the difficulties in rejecting these types of contributions, particularly where they are made through an interposed entity such as an employer, a payroll provider or a clearing house. In those circumstances it can be difficult for the trustee to ensure that the contribution ends up in the hands of the member, where it should be.

Senator BERNARDI—Is three months just an arbitrary figure or is it something that works within your systems?

Ms Brady—It was a compromise. We would like quite a bit of time just to build systems, because we do not have that in place now. It is also the education time period. We understand that there would be concerns in Treasury, again, with any really lengthy time delay where people put in significant contributions in a concessionally taxed environment. You can run them around the system. The surcharge had that. They are still chasing people today. So we understand that they would have concerns. We thought that a three-month period was reasonable in that context to allow us to contact the member and for them to come back to us, particularly in the initial period, where people may not be aware that this is fairly crucial to their interests in the super fund.

Senator BERNARDI—I take your point.

Senator JOYCE—You were talking about interposed entities and transfers and the fact that, if they do not have a tax file number, you are not going to accept contributions. We end up really with the same issue. If someone gives you the wrong tax file number and they are working through an interposed entity or a labour hire firm or something like that, are there any ideas about how we would deal with a situation where someone might say, 'I have got no

intention of collecting my super, so here is my number,' and it is not a number at all? What do we do with those funds?

Ms Brady—There is an algorithm check that we have to run against tax file numbers, which will pick up the worst cases of false numbers.

Senator JOYCE—We have that same thing in accountancy.

Ms Brady—Yes. That has been raised with the ATO as a technical issue.

Senator JOYCE—You have to have that software at the site, basically.

Ms Brady—Yes, we do.

Senator JOYCE—I may go to work picking grapes in Mildura or something. They may want me to work picking bananas—that is a big one up in the north. They want me to work today. They say, 'What is your name?' I am actually on the dole and I have no intention of really telling them exactly who I am, so I give a false name and a false number. How are we going to do that? Are you saying we have to get the algorithm software to the front door of that packing shed so that they check everybody as they come in?

Ms Brady—No, the fund does it.

Senator JOYCE—By the time the fund has the money, that bloke will be gone.

Ms Brady—There are two issues here. I do not believe those people will be making personal contributions to the super fund. That is what the rejection provision applies to.

Senator JOYCE—I agree with that.

Ms Brady—Those people will have theirs taxed at the higher rate. There will be people who do not want the tax office or their employer to know their TFN. They are not obligated to give an employer a TFN to be employed either. They just want to hide under the radar. They do not care that that bit of extra tax will be taken out of super that they are probably not even going to claim.

Senator JOYCE—That is the point I am getting to: what do we do with that money in the end?

Ms Brady—It will probably go to the lost or unclaimed area.

Senator JOYCE—Does it just sit there?

Ms Brady—It goes to the states or the government. It goes to consolidated revenue, I think.

Senator SHERRY—If there is any left by the time you get to it.

Senator JOYCE—That is an interesting answer in itself.

Ms Brady—Sure. But if you are an overseas itinerant worker—

Senator JOYCE—How long do we wait before it gets to that? I am curious. How long do we wait before it is obvious that no-one is going to claim it and we throw it back into the public coffers and build a bridge or put an air conditioner into a school?

Mr O'Shaughnessy—There are statutory limits.

Senator SHERRY—Is that on age 60 or 65?

Ms Brady—Age 65, pretty much. It depends on the jurisdiction you are covered by. We ERF most of ours, so they are protected.

Senator SHERRY—Members protected in an ERF!

Ms Brady—If they are under $1,000.

Senator SHERRY—I think you will find that they are not member protected in an ERF. It is one of the reasons why that money is transferred in some cases.

Ms Brady—It is less than what it might otherwise be.

Senator SHERRY—Yes.

Senator BERNARDI—We have talked about the closed-end funds and the difficulty in calculating the pre-83 component for some of them. I have to be frank: if we started implementing the procedures now, you would have until 2008. That gives you 18 months, more or less, to handle what, by your own admission, is a small percentage of superannuation fund accounts. I do not believe there are any new closed funds opening up, are there?

Mr O'Shaughnessy—There are more funds closing. We are talking about up until 1 July 2006.

Senator BERNARDI—You are proposing another three years on top of that, so it is really 4½ years. It seems like a long time to get a few administrative procedures in train. I understand you are talking about specific events triggering it and having to calculate it for individuals. Is it that hard to get it sorted out earlier?

Mr O'Shaughnessy—If it were the only thing that our members had to do—

Senator BERNARDI—Your members are very capable.

Mr O'Shaughnessy—They are. I think the reality is that a lot of these funds sit on legacy platforms. They are legacy products. It is very much a manually driven process. What we are recommending does not have any disadvantage for the member at all. If they make an inquiry, we actually go through that calculation process. Amongst all the other changes that this package brings, to have some more time to actually be able to account for the pre-83 contributions is probably a smart move.

Senator BERNARDI—It is a lot more time though, is it not?

Mr O'Shaughnessy—It is. But, again, there is zero disadvantage for the consumers in our recommendation.

Senator BERNARDI—I raise it because it seems to be a little excessive from my perspective, but I accept that you are dealing with your members and you are trying to represent their interests.

Senator JOYCE—When you were going through the submissions, did you see the correspondence in regard to defence personnel and pre-1988 contributions, and the arguments about whether they were deemed to be undeducted or not undeducted?

Mr O'Shaughnessy—I am not familiar with the issue.

Ms Lee—I am actually not familiar with it either.

Senator JOYCE—If you are not then do not worry about it.

Senator SHERRY—We have had a lot of correspondence from people who are to retire or have already retired from the general Public Service, including the Defence Force, regarding issues around the 10 per cent rebate for untaxed schemes. You are not familiar with any of the issues?

Mr O'Shaughnessy—I am familiar with the issue but I am not up to speed on the detail of the issue.

ACTING CHAIR—We are definitely going to hear some more evidence about that particular issue from other witnesses. There being no further questions, thank you very much for your attendance this morning. We appreciate your submission and your contribution to the inquiry.

Proceedings suspended from 11.30 am to 11.42 am

WARD, Mr John David, Manager, Research and Information, Mercer Human Resource Consulting

ACTING CHAIR—Welcome, Mr Ward. Would you like to make an opening statement?

Mr Ward—I thank you for the opportunity to make a presentation this morning. Mercer has wide experience in the superannuation field. Not only do we manage a major wholesale master trust with assets worth over $10 billion but also we administer a number of large corporate superannuation funds, we provide consulting, actuarial and investment advice to superannuation funds and we have our own financial planning arm. I should highlight at the start that Mercer strongly supports the overall thrust of the proposed changes in the simpler super package. It is a good package which needs to be implemented, in the main, from July 2007. However, we do have some serious concerns about some aspects of the bill and their workability. We believe that most of these can be addressed without affecting the integrity of the new system.

I would like to highlight some issues in regard to tax file numbers, which I know have been covered significantly already this morning. It is our view that for the system to work, members really need to provide their TFN to their superannuation fund. The current significant level of non-disclosure is going to be a major barrier to the success of the new system. Current non-disclosure is partly a result of inertia and partly due to conflicting regulatory requirements. In particular, APRA have set such high barriers for passing TFNs to a super fund that the supply of TFNs has been actively discouraged. Even if a member ticks the ATO tax file declaration form and hands that to his employer, if the employer passes that to the fund, that would be in breach of APRA's guidelines. The form does not provide enough information, as required by APRA.

From experience, we believe that any advertising campaign or letter-writing campaign to members is unlikely to be successful. It will get some, but nowhere near enough. Yet, for the system to work, we need those TFNs. To get a sufficient volume of TFNs, we believe that several things need to happen. Firstly, APRA need to change and simplify their current requirements. Secondly, employers should be required to provide TFNs for existing employees as well as new employees. It is our understanding that the new proposed rules will, in effect, only really help for new employees, not for existing employees, and that needs to be addressed. Also, the ATO should pass on any TFN details it has been able to match. I make the comment that superannuation has really become part of an employee's remuneration. The employer can use the TFN for other aspects of remuneration. Why can't it be used automatically for the superannuation part of remuneration?

Another significant inefficiency is going to be the method of collection of the additional no-TFN tax. We do not understand why a totally different system has been established in this case than that which operates in, say, the employment system or the banking system. In those systems, if a TFN is not disclosed, the additional tax is effectively paid by the employee or the investor. The employer withholds additional tax from the salary payments. The bank withholds additional tax from the interest. Yet the proposed system for superannuation is totally different. It is not the member of the fund who gets hit for the tax on the first instance;

it is actually the fund itself. The fund itself is liable. Okay, the fund will adjust the member's benefit to reclaim that tax from the member's account, but it is important that the fund is the entity that is liable for the additional tax. So that means that, when a member leaves in, say, July this year, the trustee is going to have to deduct amounts from benefits paid on a very small amount of contributions, perhaps, and hold that back until the end of the year when it passes on that no-TFN tax to the ATO. It is the fund that has to claim the money back from the ATO, not the member; whereas, in the normal environment, it is the employee who would claim the money back. Why is it different in superannuation? We do not really understand the reason.

If a member does supply his TFN, the fund can only claim it back when it submits its next tax return. That could be 12 months or more away, by which time the member may no longer be a member of the fund. The fund claims the refund, but it no longer has a member. The system does not work. Even if the fund tries to reinstate the member, technically that is in breach of Corporations Act requirements because a new member would need to sign an application form. At the end of the day, the other members of the fund are going to be paying much higher administration costs to cover the costs incurred by the fund in processing refunds of this no-TFN tax. There will be many cases where the member will not be able to get a refund, perhaps because the fund is wound up.

We believe that there is a much easier and more efficient system which could be implemented, and we have outlined that in our submission. Broadly, at the end of the year the fund would advise the member that so much no-TFN tax has been deducted. That would be on a form, which the member would fill in their tax file number on and send straight to the tax office with details of their current super fund and the tax office would then pay the money straight to the member's current fund. It puts all of the onus back on the member, it minimises costs on the fund and it should involve a much quicker and cleaner process.

Our submission also highlighted some of the issues on death benefits. In particular, from a communication point of view, if you are a member over the age of 60, the trustee can say: 'You are over 60. Your benefit from now on will be tax free—unless you die. And we cannot tell you how much tax you are going to pay until we determine who is actually going to get the benefit. But if you are smart and if you are quick enough, you can avoid all the tax by withdrawing your super before you die. And, by the way, there are other things you can do before or shortly after you retire to remove or significantly reduce the potential tax on death. Just make sure you get the right advice.'

Those who have significant amounts will no doubt get advice. They can avoid the tax. It is those lower income earners who have not got a very large benefit who are more likely to be paying this death tax at some future point. We have also raised concerns about the tax on those who are still employed. There is no real change from current law, but the death tax can be as high as 30 per cent on death benefits, which is double the 15 per cent tax level which was indicated on budget night and restated in the 5 September announcements. So there are a whole range of anomalies that can arise on death, and some adjustments or removal of tax in certain circumstances on death is our recommendation.

We have also covered a number of other issues, such as invalidity benefits, where much more clarification is required. The bill seems to have some serious deficiencies there. With

termination payments made by employers, again, there are some anomalies in the payment of death benefits and where benefits are rolled over during the transitional period. And there are some significant concerns for employers. For an employer whose 2007-08 tax year started on 1 January this year, they still do not know—and there has been no government announcement—whether they will get a tax deduction for a large contribution made today. We are almost a month into the year and they still do not know whether they are going to get a deduction for all their contributions. Urgent clarification is needed.

There are also issues with employers contributing after an employee has left service. And that is common practice: that an employer's pay system just does not enable them to make sure that all superannuation contributions are made before an employee leaves, and there are some cases where an employer is going to lose a tax deduction just because they have paid a contribution after the date of termination.

There are a number of other issues in our submission, which I will not mention now, but important are administration issues. There are only five months to go until the start date. We do not want to defer the start date; we cannot do that. But we are still in the position where much of the fine detail is not known. Funds have to make major changes to administration systems when we do not know all the detail. Funds are really going to need to concentrate on the important issues, and there are a number of less important issues, which do not really affect the overall package, which we believe should be deferred or removed. We have outlined some of those in our submission.

In summary, this is a good package. It is important that it goes ahead from 1 July. But to make it work more efficiently, some modifications are necessary.

ACTING CHAIR—Thank you very much, Mr Ward. Thank you also for your very comprehensive submission, which has provided us with some case studies that illustrate the arguments that your organisation is making. You raised the issue of the conflict between the APRA guidelines and the reporting of tax file numbers. Did you raise that in your consultation process with Treasury?

Mr Ward—Yes, we have.

ACTING CHAIR—What was the response?

Mr Ward—Nothing concrete.

ACTING CHAIR—Did they give you any reasons for adhering to the proposals that are in the bill?

Mr Ward—I think Treasury were unaware of the issue initially and even APRA have probably forgotten that they ever came up with these guidelines. In fact, I think they were initially put out by the ISC before APRA came into existence. But they are still on the front page of APRA's superannuation website. They are quite onerous. There is quite a number of bits of information that need to be provided to the employee when he wants to provide his tax file number in that way. Even if an employee rings up the helpline of their superannuation fund, based on the APRA requirements the helpline has to say: 'Sorry, I can't take your TFN on this phone number because it's not secure. You'll have to ring back on a different phone number.' The helpline gives them the phone number and they ring back and say, 'I'd like to

disclose my tax file number.' The helpline says, 'Okay, before you disclose your tax file number, I have to make you aware of certain things.' Then the person on the phone has to read through a screed that takes three or four minutes to read through before the employee can provide his TFN over the phone. In many cases the employee says: 'I just want to provide my TFN. I don't want all those words.'

ACTING CHAIR—So you have raised this with Treasury. Have you had an opportunity to raise it with APRA other than in those consultations?

Mr Ward—APRA have been involved in some of those consultations, so they are aware of the issue.

Senator SHERRY—Thanks for your comments about the tax on non-TFN. I think you have really hit the critical points, particularly the issue of inertia, in this area. We have canvassed it in considerable detail with ASFA. You would like to see a deferral of the TFN issue for a period of time until a more effective regime can be worked out.

Mr Ward—We did not actually make that recommendation in our submission, mainly because we did not think it would get up. But, yes, we would be very happy for a deferral of the whole no-TFN issue. A 12-month deferral there would help considerably. We did actually suggest that we defer the requirements to refuse to accept non-concessional contributions from people who have not supplied a TFN. I think ASFA's submission goes further than that, and I would support that.

Senator SHERRY—You say in your submission in one of the dot points:

- It is likely that many members will never recoup the no-TFN tax paid.

Why would it be likely? They get a statement. They see that the tax has been applied to them. Why wouldn't they apply for the tax to be repaid to them?

Mr Ward—Largely inertia. Often you will find that members just do not read or do not understand their statement. It is not something that has come out of their pocket, as it would if it was a salary payment. It is all in the future. It just gets thrown in the bottom drawer or the wastepaper bin. They do not read it. With those that do, inertia will mean that they will forget or will not get around to it. In other cases, they will not be able to because they are outside the three-year period in which you can claim a refund. Or, under this system, if the fund has wound up, it is too late, because it is the fund that has to claim the refund.

Senator SHERRY—And this group of people with inertia are likely to be people who are functionally illiterate. A significant proportion of people are functionally illiterate. For example, they can read some things but cannot read, understand or fill in basic forms or respond to requests for information that require any form of process.

Mr Ward—Yes, I think that is right, although I expect that even more literate people will also fail to read their statement and get their TFN to the fund.

Senator SHERRY—We have well canvassed that issue. Let's go to the issue of the death tax—and thanks for the examples you give us; I think they are very useful. Do you have an estimate or would you be able to provide the committee with an estimate of the loss to revenue if there were effectively no death tax at all, if it were removed?

Mr Ward—No, I cannot give you an estimate, I am sorry. It is a new system. There is going to be a lot more money retained in the superannuation system by people over the age of 60, so the amounts involved are likely to be considerably greater than they have been in the past. But what concerns us in particular is that those who are in the know will get their money out first and will avoid the tax anyway. Those that are in the know will set up their pension when they retire and, using withdrawal and recontribution strategies, will be able to almost entirely avoid the tax in future. If they get advice from a financial planner, they will be withdrawing their money at 60 and recontributing it, and that effectively takes most of the death tax away.

Senator SHERRY—You said the tax application can be up to 30 per cent. Why is it up to 30 per cent?

Mr Ward—Where a fund claims a tax deduction for insurance premiums, which is normal, there is a formula which approximates to the future service component of the death benefit. That is treated as an untaxed element and taxed at 30 per cent. So in effect the death benefit is split into two bits: there is the bit for past service, which is taxed at 15 per cent if it is paid to a nondependant, and the future service bit is taxed at 30 per cent. So for a young person who has just joined their first superannuation fund, the way the formula works is that, if they died on the first day, the whole death benefit would be taxed at 30 per cent. If they do not die until they are about 65, the whole benefit would be taxed at 15 per cent.

Senator SHERRY—Could I suggest on this issue it would be useful to have some indicative figure at least. I assume you have some liaison with other superannuation organisations. Conceptually what you are arguing I think is logical and sensible, but at the end of the day we always have to have regard to revenue issues. It would be useful to get some indicative figure of the impact of not having a death tax application.

Mr Ward—I am not sure that we have the data that would enable us to work that out.

Senator SHERRY—Have you asked the tax office about the data in this area?

Mr Ward—No, we have not, but even the tax office data would be based on the old system, where people were required to take their money out of the system unless it was in a pension, whereas the new system is much more flexible and there will be much more money in the system. But if people can avoid it the day before death by getting their money out—

Senator SHERRY—They will.

Mr Ward—they will.

Senator SHERRY—Yes, I accept that point.

Mr Ward—So you can argue that the government will collect very little tax revenue from this current tax anyway because all those in the know, except those who get run over by a bus, will be able to avoid it.

Senator SHERRY—And presumably if a person was not terminally ill they are more likely to try and avoid the tax payment. If they are in their 70s, for example, they are more likely to turn their minds to structuring their affairs not to pay the tax in the first place, presumably.

Mr Ward—Yes.

Senator SHERRY—Let's go to the issue of the overseas transfers, which I touched on earlier and which you referred to in your submission. Again, how is this best dealt with? The bills will be passed and supported by the Labor opposition. Is it still possible to deal with this issue later, if you like, and try and come up with some constructive solutions to overseas transfers?

Mr Ward—I agreed with all of the comments on that issue earlier this morning. It would be possible to address that at a later date. I agree there do need to be anti-avoidance provisions in there, but for a bona fide transfer it just seems illogical that we should be forcing people to keep their money out of Australia. I thought we wanted money in Australia.

Senator SHERRY—I know there are some practices that have a high proportion of persons for whom they act transferring money from jurisdictions like the UK and the US in particular. Do Mercer have any practical experience in this area?

Mr Ward—We have a number of large international clients who regularly transfer staff from, say, the UK to Australia, often on a permanent basis, sometimes not. Certainly where it is a permanent transfer they would be quite keen to transfer the UK money—or the US money, or wherever it is from—into Australia.

Senator SHERRY—Logically, whatever the tax regime in Australia or the UK, you would prefer, I would have thought, if you are permanently transferred and presumably you are going to stay here for a long time, if not in your retirement years, to have the money in the jurisdiction in which you are working and otherwise paying tax—

Mr Ward—And you are wearing the exchange risk if you leave it overseas.

Senator BERNARDI—For good or for bad.

Mr Ward—For good or for bad.

Senator SHERRY—I have been made aware of these issues particularly from the UK. Is that in part because of the significant number of people who work in Australia from the UK and the fact that they have a very extensive private pension system as distinct from the European jurisdiction, where there is not such an extensive private pension system; it is a state run system?

Mr Ward—I think it is both of those. We do have a problem with the UK anyway in that the UK have certain rules on transferring to overseas countries. Whether the UK authorities will continue to allow transfers of benefits from the UK system to Australia once Australian benefits are effectively tax free is another question. The UK authorities are still grappling with that at the moment. But from our point of view, if there is a requirement from an overseas jurisdiction that does not allow the money out of that jurisdiction, we cannot do much about that. But, where there are no such limitations, why should we try and keep the money from coming into Australia?

Senator BERNARDI—I have a question with regard to a comment you made in your introductory statement about the refund of excess tax. You said that there might be a situation where a policyholder no longer was a member of the fund and there would be some difficulty for the fund then to credit them with the refund of tax, because the fund does not receive it for

12 months. That is just an internal money-juggling issue rather than a specific issue of an individual missing out. Am I right in that?

Mr Ward—If the person is no longer a member when the fund gets the refund of the no-TFN tax, what does the fund do with it? Obviously it does not want to pocket it itself. It has got to pass it on to that former member. It is the process of how the fund gets that money to that member. It has lost contact with the member because he has not been a member. He may no longer be in the fund that he initially transferred to. How does all of that work?

Senator BERNARDI—I understand what you are saying. Perhaps I did not clarify the position. If a member provides his tax file number, the fund would, I believe, immediately credit him with the excess tax that is paid and the fund itself would not receive the credit from the ATO until it lodged its tax return. Is that right?

Mr Ward—I do not believe that is possible—

Senator BERNARDI—It is not possible?

Mr Ward—because for an accumulation fund, effectively, all the amounts in the fund have to be allocated to members. If you are in a fund that is operated on a unit-pricing system, all the members have purchased their number of units and there is the money backing their units. The trustee cannot, all of a sudden, drag $300 out of the air to on-pay to a member who has just disclosed their TFN. They will not get that $300, or whatever the amount is, until they get the money back from the ATO. All the money they have is allocated amongst other members, so unless they can take it off other members, which would breach other SIS requirements, they cannot pay it straight to the member. They have to wait until they get it back from the ATO.

Senator BERNARDI—I understand what you are saying and I find it interesting.

Mr Ward—Some funds would have reserves.

Senator BERNARDI—That was my next point.

Mr Ward—That might be possible, but for a standard accumulation fund there may be no such reserves to draw that money from.

Senator BERNARDI—As a general rule of thumb, can you estimate how many funds—most, half?

Mr Ward—As a general rule—it would only be a guess—and, in any event, those reserves are generally being used for other purposes: either as an investment fluctuation reserve or other contingencies.

Senator BERNARDI—That could be defined as a contingency. Thank you for clarifying that.

Mr Ward—If it is one member who is owed $300, it is a bit different from 1,000 members.

Senator BERNARDI—Thank you for clarifying that. I do appreciate that. We talked about the collection of tax file number data and the disclosure regime when you collect tax file data. That sort of disclosure is consistent among a whole range of financial products, as you would be well aware, for banks and all those sorts of organisations. It is a pain. Equally, it is there to

ensure that people are fully informed of the services and the conditions under which they are getting that information. Thank you for your submission. It is very well considered and very well laid out. It raises a number of very good points, but I just pick up on those two.

ACTING CHAIR—Mr Ward, we have canvassed most of the critical issues that you have raised in your submission. But I did want to take you to the point on page 17 where you raised what you see as an inconsistency between the bill and the explanatory memorandum on the issue of invalidity benefits. Perhaps you could just elaborate a little on your concerns there.

Mr Ward—If a member who has been disabled in the past but has not taken any benefit from the fund were to take a benefit from the fund, they would currently qualify for a post June 1994 invalidity component, assuming they have met various disability requirements in the legislation. The bill seems to say that, come 30 June 2007, we have to crystallise the pre-1983 component, but it does not actually say we crystallise the pre-1983 component. It says we have to crystallise a number of components. One of those is the post June 1994 invalidity component. The way the bill reads is that you assume the benefit is being paid, and that would generate a post June 1994 invalidity component. When you read the explanatory memorandum, it says that does not happen. The bill seems quite clear, yet the explanatory memorandum says exactly the opposite: you do not crystallise a post June 1994 invalidity component, except in the case where it involves an amount that has been transferred from another fund. So there is certainly an inconsistency there.

That also highlights a big inconsistency in current law with invalidity components which we would have liked to be fixed up as part of this simplification process and which we have raised in previous submissions to Treasury. If a member who becomes disabled and leaves their job were to take their money out of their current super fund, either in cash or rolling it over, they would immediately get this post-1994 invalidity component, and that is fixed for the future. If they decide to leave their money in their current super fund, that post June 1994 invalidity component would not be calculated until they actually took the benefit. So there is a big difference in timing.

We are also concerned, the way the bill is worded, where somebody has left their money in the fund and they eventually come to take a benefit that they may miss out on their post-1994 invalidity component because of the slight change in the wording from the old to the new bill. I am not sure that that is the intention but there would seem to be a risk of interpreting it in that way.

ACTING CHAIR—Were you able to raise this issue with Treasury during the consultations?

Mr Ward—We did earlier on in the consultation process when what came out in the bill was a little bit different from what we had expected. We were certainly made aware of it again.

ACTING CHAIR—We have canvassed the issues in your submission, Mr Ward. Thank you very much for your evidence today and for your submission. As I said, the case studies illustrated your arguments very effectively. We appreciate that very much. Thank you for your time.

Proceedings suspended from 12.17 pm to 1.46 pm

ADAMS, Commodore Harold John Parker (Retired), National President, Regular Defence Force Welfare Association

GRIFFITHS, Lieutenant Commander Richard David (Retired), National Secretary, Regular Defence Force Welfare Association

MORRALL, Group Captain Philip Leslie (Retired), Vice President, Pay and Conditions of Service, Regular Defence Force Welfare Association

WADE, Mr Colin, Member, Regular Defence Force Welfare Association

GRAHAM, Mr John, Private capacity

ACTING CHAIR—I welcome the representatives of the Regular Defence Force Welfare Association, who have provided submission No. 4. You may not have been here this morning when I made the opening statement where I reflected on the issue of parliamentary privilege. You are protected by parliamentary privilege. Do you have any comments to make on the capacity in which you appear?

Mr Wade—I am a retired wing commander from the Air Force.

ACTING CHAIR—Thank you. Commodore Adams, do you wish to make an opening statement?

Cdre Adams—Yes, thank you. The issues that the RDFWA have been pressing through our submissions to Treasury, defence-oriented politicians, the service chiefs and now this committee are that the proposed legislation's age trigger of 60 years fails to acknowledge and accommodate the provisions of Australian Defence Force service for compulsory and involuntary termination of full-time service on grounds of age and medical condition and in other management-initiated circumstances. The proposed legislation's age trigger of 60 years and the proposed reversionary benefit provisions fail to acknowledge and accommodate the circumstances associated with the death of a serving Defence Force member, the subsequent death of a Defence Force member consequent upon compulsory termination on medical grounds from causes associated with that termination and the consequent impact upon the entitled spouse and dependent children.

The very names of the current military schemes—the Defence Force Retirement and Death Benefits Scheme and the Military Superannuation Benefits Scheme—indicate they are intended to deal with circumstances beyond those encountered by members of normal superannuation funds. As a caveat, I should emphasise that the RDFWA's submissions and concerns relate to personnel who, upon involuntary discharge, do not enter the workforce. We are not talking about personnel who resign to commence a second career. In addition, in its submissions, the RDFWA has requested that, whatever the outcome with respect to this legislation, careful consideration be given to the consequences of the new provisions as related to Veterans' Affairs and Centrelink entitlements.

Service personnel have long had special superannuation and compensation schemes which are tailored to the unusual requirements of military service and the defence of Australia. We believe that this simplified superannuation legislation does not take this into account. The question is: can this simplified superannuation legislation be modified to cover military

personnel adequately and should their exceptional circumstances be recognised outside the legislation? At the very least, if this committee can make no other changes to this legislation, the RDFWA would ask that tax-free status be extended to all recipients of military class A invalidity pensions—that is those who are unable ever to work again—irrespective of their age, rather than making them wait until they turn 60. That is the basis of our submission.

ACTING CHAIR—Mr Wade, you have made your own submission to the inquiry. Do you want to make any additional comments?

Mr Wade—Yes. As I said earlier, I was a wing commander in the Air Force and I retired on medical grounds. I am currently cat. A, which is the category the commodore was talking about. As the committee would appreciate, the recommendation for tax exemption for eligible military invalidity pensions is really about the recognition of the uniqueness of military service in the Australian Defence Force, the need for equity and fairness in the application of the new legislation and the recognition of the associated recruitment and retention benefits for the Australian Defence Force. The big picture that we are talking about encompasses the financial security in retirement of approximately 55,000 permanent members of the Australian Defence Force, 22,000 defence reservists, retired members of the Australian Defence Force and all their immediate family members. We are talking about a decision that impacts on potentially millions of Australians and also the operational capability of the Australian Defence Force.

The commitment and professionalism of members of the Australian Defence Force is well recognised by the government and the Australian people. All members of the Australian Defence Force are professionals, competitively selected from the cream of Australia's youth, highly trained and qualified, with many possessing the potential for extensive advancement within their chosen military careers or subsequent civilian employment. We are dealing with real people with real families, real careers and real personal retirement goals. Training and operational incidents involving the death or disability of servicemen and servicewomen are unavoidable in the context of Australian Defence Force employment, training and operational deployment. Unfortunately, some servicemen and servicewomen are medically discharged from the Australian Defence Force with permanent, employment-terminating disabilities that preclude them from employment not only within the Australian Defence Force but, in many instances, all future employment.

The government is to be commended for the initiatives within the superannuation legislation which build on existing superannuation and taxation legislation and provide further incentives for Australians to work and save for their retirement. However, while incorporating extremely generous transitional arrangements to ensure that Australians who were planning imminent retirement may benefit from the superannuation changes, the legislation fails to recognise the adverse impact on retirement security that is faced by members of the Australian Defence Force who are medically discharged as a result of service-attributable disabilities. Recipients of invalidity pensions from the military superannuation schemes cannot benefit from the wide range of government incentives and initiatives available to normal taxpayers in both the taxed and untaxed superannuation schemes. Accordingly, urgent consideration should be given to recognise tax exemption, particularly for the cat. A people, for members of the Australian Defence Force who are medically discharged as a result of service-attributable

disabilities—as is commendably recognised by the UK and US governments. Yes, the governments of Australia's two major defence allies have recognised the uniqueness of military service and provide tax exemption for members of their armed forces who are medically discharged as a result of service-attributable disabilities.

It is equally anomalous that the Australian government fails to recognise tax exemption for Australian servicemen and servicewomen, yet recognises tax exemption for Australian residents in receipt of military wounds and disability pensions granted by foreign governments on the basis of the same legislation that constituted the High Court judgement in 1977 recognising tax exemption for Australian military invalidity pensions. I respectfully ask the committee to remember Lieutenant Commander Fred Goodfellow RAN, in his journey from a highly qualified and experienced pilot to a man in a wheelchair, when considering the merits of our submission. Much has changed since Lieutenant Commander Goodfellow's High Court case, which he won by the unanimous decision of three High Court judges. The government has now reintroduced tax exemption into the superannuation agenda. It is now an appropriate time for this committee and the government to recognise the legitimacy and the legality of the High Court judgement in 1977 and to recognise tax exemption for Australian military invalidity pensions. We do not want your sympathy; we want your recognition.

ACTING CHAIR—Thank you very much, Mr Wade, and I thank you for your very comprehensive submission which outlines the details of your concerns and the argument. Mr Graham, do you have an opening statement?

Mr Graham—I do; thank you for the opportunity. The Treasurer's response to inquiries on an unfunded superannuation scheme was given in a letter dated 14 July 2006. Public sector superannuation schemes were to be excluded from the full benefits of proposed legislation. My submission is related primarily to defence forces superannuation.

Responding to a constituent of Mr Philip Ruddock, Mr Costello stated that his primary reason for not treating all superannuants equally was:

> Benefits paid from an untaxed source would still be taxed under the government's plan. To remove the tax on these benefits would mean that members of these funds would pay no tax on this part of their superannuation. This would be an unfair advantage to members of these funds as they have not paid the contributions and earnings tax that 90 per cent of Australians have paid on their benefits.

Taxation on these elements was only introduced post 1988. From 1948 to 1988, in the case of defence superannuation, both public and private sector funds for taxation purposes were treated in exactly the same manner. Even though there was no DFRB fund post 1973, effectively those who were discharged up to the date of introduction of those taxes do not come into the Treasurer's definition that all public sector superannuants had an advantage. As I have said, both sectors had a period of at least 40 years when there were no taxes on those funds. Indeed, the private sector funds had the advantage of their funds being invested tax free up to 1988. Whilst the DFRB funds were applied to the government spending plans, the only financial advantage was to the government.

I ask: should retired sailors, soldiers and airmen, including veterans of the Korean War and many other conflicts after that, accept that they should now be excluded from the total benefits of the proposed legislation because the Treasurer considers that they did not pay for

their superannuation and had not paid non-existent taxes on their contributions and fund earnings?

I cannot explain to them why they are to be treated differently from their private sector peers. DFRB superannuants were compelled to join these schemes and compelled to pay a fixed percentage of their military pay, after tax, in contributions, with no option to decline membership and join some of the excellent commercial schemes available at that time. Under the PSS and MSBS, which is the latest military scheme, they receive a total refund of their contributions in the form of a lump sum. DFRB superannuants do not. They have to take an advance on their benefit commutation and accept a lower fortnightly superannuation payment to obtain a lump sum. I am not criticising these other public sector schemes, but I need to highlight the differences between those and the one I am speaking about to show that all public sector superannuation schemes cannot be lumped together in these considerations.

In my detailed representation I have briefly discussed some other aspects of the DFRB relating to the history of the fund. I have no intention of addressing these fringe matters here. They are more for the Minister for Veterans' Affairs. There are people, including some sitting at this table, far more knowledgeable than me in these matters, and they will take you through that. Much of the information in my submission is extracted from the report of a former joint select committee on the Defence Force retirement legislation, chaired by the late Senator John Jess, a senator who, by the way, was very much respected in the defence community in the sixties. He sorted out many anomalies that were in the act at the time, particularly for those people who were contributors prior to 1959.

Last year the Prime Minister asked the public to give politicians a fair go in relation to the new parliamentary superannuation scheme. All I am asking for is the same consideration: a fair go for the government's own employees. I am asking not for special exemption from taxes and things but for equity with other superannuants in the community. Diggers should not be punished for the government policy of putting off its financial obligation to employees, whilst the government uses their contributions for the benefit of the whole population.

I urge you to recommend to parliament that it abandon the proposed discriminatory policy against public sector superannuants and grant the full proposed concessions to all Australian superannuants, regardless of present funding classification. If not, I believe the DFRB superannuants should not be included as 'unfunded'.

ACTING CHAIR—Thank you. Commodore Adams, to what extent have you had these kinds of conversations and raised these issues with Treasury during the consultation process for this bill?

Cdre Adams—Our submission went to Treasury and, through our links with the Australian Council of Public Sector Retiree Organisations, we had extensive talks with Treasury and also ComSuper in arriving at our response to the general overall package. The general overall package of the 10 per cent offset—and we tried to get a balance on it, as to how that weighed up against the tax-free status of the other ones—satisfied us that the 10 per cent offset was well arrived at, and we did not have any particular difficulties with that. On the particular issues that we raised in relation to Defence Force personnel, there was no dialogue with Treasury.

Senator SHERRY—Just to be clear on this point: when you say there was no dialogue, to your knowledge are Treasury aware of this issue?

Cdre Adams—We made a detailed submission to Treasury on this particular issue of the unique nature of military service and how it had to be accommodated in the legislation. That was also represented to the service chiefs and the Minister Assisting the Minister for Defence. So the government was aware that we had done that. As well as that, we made similar representations to selective coalition backbenchers who expressed an interest in it.

Senator SHERRY—But there has been no positive response?

Cdre Adams—The response we have had—yes, indeed, from the Chief of the Defence Force, from the minister assisting and from individual parliamentarians—is that as the legislation is drafted it was never the intention of Treasury to make special arrangements for individual sectors of the community. It was an all-in, all-out approach. That, we understand, was accepted by Defence as well as by others.

Senator SHERRY—Well, if that was accepted by Defence, why are you here today? You don't agree with Defence on this issue?

Cdre Adams—Well, no. We believe there is a major issue here because of the unique nature of military service. But Defence—

Senator SHERRY—I understand that, and I want to go to that in a moment, but I am just trying to get clear in my mind who is saying what. To your knowledge, do the Department of Defence and the heads of Defence accept the outcome in the bills we have got before us?

Cdre Adams—Yes.

Senator SHERRY—After making representations, they are accepting it?

Cdre Adams—We have not seen any dialogue between Defence and others. But, having seen the CDF's letter and the minister's letter, the wording is exactly the same and it would appear that Defence has accepted Treasury's advice that there are no special provisions for special sections of the community.

Senator SHERRY—Okay. I just wanted to go to some specifics you mentioned, Mr Wade. Can you tell us the approximate number of individuals who come under what I think you referred to as class A invalidity—the number of Defence Force personnel.

Mr Wade—In the 2005-06 financial year, there were 6,060 invalidity pensioners in total. That includes class A and class B. Unfortunately, I could not get the break-up from ComSuper; they could not divulge it to me. That was an increase on the previous financial year, from 5,342. In the financial year 2004-06, the total cost of those 5,342 invalidity pensioners incurred by the government was $115 million, and that is in the ComSuper report to parliament.

Senator SHERRY—But the more specific detail which you asked ComSuper for has not been provided?

Mr Wade—I requested it formally from ComSuper. They formally advised me that they could not advise me as a private citizen of that breakdown. I endeavoured to provide for today the breakdown by age, by class A and class B, by the numbers, by the amounts and by the

number of people over the age of 60 that were in receipt of the respective pensions, but unfortunately I could not get that information.

Senator SHERRY—Okay. Maybe we can put some questions on notice and get the material for you.

Senator MASON—Chair, if I might—

ACTING CHAIR—Yes.

Senator MASON—Sir, I wanted to ask you what proportion of military personnel are medically discharged for service related reasons. Is that one of the questions you have asked ComSuper?

Mr Wade—The numbers are—

Senator MASON—What proportion—what percentage?

Mr Wade—As a percentage? I have been on both sides of the camp. When I was serving, I was on the boards within ComSuper that actually reviewed pensions. But I could not advise you of the total numbers.

Senator MASON—Thank you.

Senator SHERRY—If the Defence Force consists of 55,000, with 22,000 reservists—those are the figures—the current beneficiaries, at just over 6,000, would represent a Defence Force personnel number far greater than 55,000 and 22,000. It would be going back over 20 or 30 years.

Cdre Adams—It is a small percentage.

Mr Wade—It would be a very small percentage. It is not a decision that is taken very lightly by either Defence or ComSuper. It is a decision when there is no hope: the person cannot pass the fitness test, they cannot undertake their job. We talk about category A and category B; there is also a category C, where the member is medically discharged but has an assessment of below 30 per cent so there is no entitlement to a pension. So there is that number as well, but they do not get a pension.

The only people who get pensions are those in category A and category B. That assessment is not permanent until those people approach the age of 60 or if they are severely incapacitated, such as those who are paraplegics. Those people will get assessed on their employability for civilian employment at a much earlier date. They are the critical people for whom we need to endeavour to cater. I have met them. I am one. Look inside me. I am sorry; it is not easy for me.

Senator SHERRY—Would we have to get the breakdown of the figures in each of those categories from ComSuper?

Mr Wade—Yes, that would have to come from ComSuper. I would be guessing at the breakdown.

Senator SHERRY—I am sure we can get it if we ask for it.

Mr Wade—The average pension for category A people is in the vicinity of $35,000. The man who was made a paraplegic as a result of the 1996 Blackhawk disaster is now 40 years of age. He is on just under $35,000 a year. It is indexed, but that is his salary for life.

Senator BERNARDI—Is it tax free?

Mr Wade—No, sir.

Senator BERNARDI—Under the existing regime, you would have to pay tax.

Mr Wade—Under the existing rules, it is taxed at the marginal tax rate. From that $34,000-odd he gets about $28,000 net.

Senator BERNARDI—How will the changes to this simplified superannuation affect someone in that category if their pension is not tax free?

Group Capt. Morrall—It will not affect them at all until they turn 60.

Senator BERNARDI—At the age of 60, they will continue to pay tax—is that right?

Group Capt. Morrall—At the age of 60, they would be eligible for the proposed 10 per cent tax offset.

Mr Wade—We are saying that people in untaxed schemes who have a full working career with full earning capacity and who have the ability to contribute to other superannuation schemes have the ability to enhance their retirement right through to the age of 60, and then they get the 10 per cent offset. People like the recipient who was involved in the Blackhawk disaster cannot enhance their retirement income. His income is frozen at $35,000. He cannot get a second job. He cannot contribute to a second superannuation scheme because he is not earning. His retirement income is frozen, but he is going to be treated the same as a person with great capability.

Senator BERNARDI—I have another question that goes to the structural nature of this. I apologise for the simplicity of these questions, but I am trying to understand exactly how the military pension scheme works. I refer to the example you gave of the gentleman who is a paraplegic as a result of the Blackhawk crash. Does he receive that disability pension irrespective of whether he is capable of getting further employment?

Mr Wade—No, sir. ComSuper are diligent in their administration of the entitlement for category A, category B and category C. They are reviewed regularly—usually every two to three years—for the duration of the recipient's life. At some point in time you are assessed for a permanent classification. For most people it is as they are approaching 60; in this person's case it may well be earlier because his disability is obviously permanent. It is not, 'You've got category A for the rest of your life.' If the treating doctors say, 'Mr Bloggs, your medical condition indicates that you can undertake a certain type of work, that you are qualified to train,' then the category will be downgraded. If somebody is on a category B, for example, and the medical specialists say, 'We've reviewed you and your incapacity is affecting you more,' then you can go up to a class A. You can go up and down until you have that permanent classification.

Senator BERNARDI—Would that be total and permanent disability?

Mr Wade—Total and permanent. In my case, I received it last year; at 59 years of age. When I was serving, the Air Force representative from the ComSuper boards for DFRDB and MSBS scrutinised me very closely. If people are worthy of the pension, they get it. If they are not, it is gone. I could give you a dozen anecdotal examples to that effect and ComSuper can as well.

Lt Griffiths—There is also the issue that if somebody in that situation was working then presumably the taxation system would pick that up in their tax return.

Senator BERNARDI—Yes. I am just going to the nature of it. In private superannuation, if you have TPD insurance and you are totally and permanently incapacitated, you accordingly receive a lump sum or however it is paid. I understand that the military system and the service personnel have different requirements, given the nature of the work that they undertake.

Group Capt. Morrall—And in both of those schemes you cannot get a lump sum.

Senator BERNARDI—Which I appreciate.

Group Capt. Morrall—Deliberately, in both DFRDB and MSBS, invalidity people are expressly debarred from having a lump sum. They are required to take their benefit as a pension.

Senator BERNARDI—I understand the reasons for that, quite frankly, and I am sure that you do too. I have one further question which goes to the nature of what happens for service personnel. There is some discussion about this scheme, which is called 'unfunded'. Eligibility for a military pension upon discharge is normally 20 years of service. Is that right?

Group Capt. Morrall—In the DFRDB scheme you are eligible for a pension after 20 years service. In the MSBS scheme you are not. Your pension entitlements are frozen until your preservation age. The two distinct schemes with two different characters—

Senator BERNARDI—So just because you were discharged at 55, as evidenced in here, you would not be able to get it until the preservation age of 60, in this case.

Group Capt. Morrall—But for large numbers of current members of the Defence Force, the preservation age is 55. If you remember, it is gradually going to creep from 55 to 60, depending upon your birth year, for those between about 1968 and 1970-something. But, for large numbers of the current Defence Force, 55 is your preservation age.

Senator SHERRY—That is true of a considerable proportion of the entire working population, though, isn't it.

Group Capt. Morrall—Indeed. But the basis of the RDFWA submission is that those same people are faced with a compulsory retirement age of 55.

Senator BERNARDI—Yes, I understand.

Group Capt. Morrall—So you end up with a cascade of people. Generally, members of the Defence Force, except for some very senior officers, have a compulsory retirement age of 55. Then you have people, such as me, who have management-initiated early retirement at 53. Then you have members who are compulsorily retired on medical grounds at any age. And in

those medical people you have people who are in category A: 60 per cent or greater disability; category B: 30 to 60 per cent; or category C: less than 30 per cent.

Senator BERNARDI—I have one further question, and I hope you do not take it as provocative, but it goes to the nub of the unfunded issue. There is a contribution of 5½ per cent of after tax income that goes into the superannuation scheme. After 20 years service—in the DB scheme, I think it was that you described—what percentage of the salary do they get?

Group Capt. Morrall—of the final average salary?

Senator BERNARDI—Yes. The final salary.

Group Capt. Morrall—After 20 years service the pension was 35 per cent of final average salary, the final average salary being the average salary over the last three years. That was for DFRDB. Then for every year of service accumulated they get another one-point-something per cent. For example, if you did 30 years, roughly speaking, you would have got about 50 per cent of final average salary. MSBS, though, is slightly different. In MSBS the minimum contribution is five per cent of after tax salary. A member can elect to contribute up to 10 per cent. There are two sides of MSBS. My money goes into MSBS into what is, for all intents and purposes, a normal superannuation fund. It is just like a private fund.

Senator BERNARDI—An accumulation fund.

Group Capt. Morrall—An accumulation fund. At the same time over here is the unfunded government contribution which is similarly based on a percentage of final average salary. So you end up with this debate—and Mr Graham's points of view have some validity. DFRDB is an unfunded scheme. MSBS is a hybrid scheme. So it does make that issue quite complicated.

Senator SHERRY—But both schemes have a substantial level of non-funding and that level of average non-funding—because they are both defined benefit schemes—varies because of the different benefits and contributions in the different schemes.

Group Capt. Morrall—Indeed.

Senator SHERRY—Do you know what the average employer unfunded contribution is to the schemes?

Group Capt. Morrall—I do not know precisely, but I think you will find in Defence's annual report that they talk about 24 per cent. They allow 24 per cent per annum to cover the superannuation on-costs, if you will.

Senator SHERRY—Mr Wade, you have mentioned the overseas experience. I think the US and UK comparison is valid. I do not think there will be other countries that you would necessarily compare with. You say it is tax free there. Do you have any detail on the circumstances, the history—how long that has been the case, why it is the case and what the level of benefit is in those two jurisdictions?

Mr Wade—The legislation came in in 1975 to make their pensions tax exempt.

Senator SHERRY—Is this for everyone or just for invalids?

Mr Wade—Just for invalidity, service-related causes from the military with associated repatriation benefits. The two are linked—if someone is injured and assessed as unemployable, if they are medically discharged. If the action happens when they are out

fishing and it has nothing to do with their service, in the UK model they do not get tax exemption. It is black and white. The injury that causes your medical discharge has to be related to your service. So the employer, the government of the UK, has that responsibility. If you are injured in your service, in your operational training, whatever it may be, as long as there is that service link, it is tax exempt. That is assessed by the veterans' agency, which is similar to our DVA. I put a summary in my major submission on how their model works. When I started this research, for want of a better word, I did not know that the UK and the US gave tax exemptions, and I had been working in these areas for years.

Senator SHERRY—You said 1975. Is that true of both countries?

Mr Wade—That is the UK legislation. The US I am not quite—

Senator SHERRY—You have included some information in your submission on the UK.

Mr Wade—I have not seen any data on when it came in in the US.

Senator SHERRY—Perhaps you could make it available to the committee. Obviously I am not going to read it now but it would be useful to have the more detailed material you have from the UK and the US.

Mr Wade—Also in my research, I had never heard of the High Court case in 1977 which looked at this very legislation that is behind the UK tax exemption. They have a statute in their Income Tax (Earnings and Pensions) Act 2003, which is similar to the legislation we are talking about today, which limits the tax exemption purely to members of the UK military for tax exemption and it is quite specific. The medical discharge has to be as a result of a service-related injury to qualify for tax exemption. It is in there in black and white.

Senator SHERRY—I have one other issue and you may or may not know the response. In the case of an Australian benefit, there would be a reversionary benefit to a spouse?

Mr Wade—Yes, Senator.

Senator SHERRY—Is that true of the UK and the US as well?

Mr Wade—Yes, totally.

Senator SHERRY—Is the reversionary benefit in the UK and the US tax free as well?

Mr Wade—I would imagine so. That is my feeling.

Senator SHERRY—Rather than imagining—

Mr Wade—I do not know.

Senator SHERRY—You have done a lot of research already, perhaps you could just check on that and provide the secretary of the committee with the detail of the information you have gathered to date so that some or all of us could have a look at it. I do not have anything further.

Senator MASON—Group Captain, you said before, I think in response to a question from Senator Sherry, that the MSBS is a hybrid so you have accumulation as well as unfunded aspects. There must be other superannuation systems like this in Australia.

Group Capt. Morrall—The new Public Service scheme is a similar hybrid.

Senator MASON—Yes.

Group Capt. Morrall—There is a degree of similarity between the DFRDB scheme and the CSS.

Senator MASON—That was the previous scheme.

Group Capt. Morrall—Then the MSBS and the PSS came in, so generally speaking unfunded schemes are public sector, albeit I think there are a couple of private ones that are similar.

Senator MASON—I ask of course because I am trying to seek analogies in terms of treatment. Mr Graham, I noticed you wickedly mentioned the superannuation scheme for parliamentarians but we will not go there.

Mr Graham—I would like to mention those that the association of—

Senator SHERRY—We are not getting it tax free!

Mr Graham—No, you people sitting there are in the same position as DFRDB people.

Senator WEBBER—There are different levels at this table.

Mr Graham—Exactly.

Senator SHERRY—Except the electorate invalid us out!

Mr Graham—My local member is one of the trustees of your fund. I have plenty of information from him; he has been very helpful.

Senator MASON—Another time, another place.

Mr Graham—There is a case for saying that the DFRDB is also a hybrid. That opinion has been given by the Association of Superannuation Funds. I think it is worth noting.

Senator MASON—Okay, so that extends the analogy even further, Group Captain.

Group Capt. Morrall—The answer is: perhaps. I do not want to in any way undermine Mr Graham's view. When we started this RDFWA, we started from the same sort of premise, unfunded, funded, taxed, untaxed and tried as laymen to see whether we could add value to that debate. We came to the conclusion that inevitably I think it will end up with lawyers arguing chapter and verse. So we took a look at that and said, 'Perhaps there are other areas to which we can add value.' The other area was to pursue this less than 60 type approach. It is not to say that we do not recognise some of Mr Graham's views, it was a matter of what could we add value to, what did we think was achievable and then Mr Wade came along. Again I will repeat what the national president said and that is, if you can only do one thing—if you get the Treasurer on a nice day and he will only let you do one thing—then make it so that category A invalidity recipients are tax free. If you can get anything better than that, we will all applaud you but that is real bottom line, if you like, because they are without a shadow of a doubt the most deserving. I suspect that the general populace would, in the nicest sense, buy such an exception to the general rules. You can work back on permutations from there.

Senator MASON—That is in the sense the bottom line. Senator Bernardi was asking about that.

Group Capt. Morrall—Yes, at the end of the day if you can only get one thing.

Senator BERNARDI—For the record, the Treasurer has many, many good days.

ACTING CHAIR—Thank you, Senator Bernardi—we all heard that.

Senator SHERRY—He has probably had no good days since the budget on this issue. What is that—about 70 or 80?

ACTING CHAIR—Senator Joyce, do you have any questions?

Senator JOYCE—No. You have been covering, obviously, the pre-ADA pension issue?

Group Capt. Morrall—Yes.

ACTING CHAIR—Mr Wade, did you have something else to say?

Mr Wade—There is one case that I really think personifies, if that is the right word, the plight of the class A invalidity pensioners—that is, the case of Fred Goodfellow. I had never heard of Fred until his name cropped up on the computer—Fred Goodfellow, High Court. This person was born and trained in Canada and was recruited into the Royal Australian Navy because of his expertise. He was a highly qualified A4 Skyhawk pilot who was recruited into the Navy on our introduction of the Skyhawks in 1966. His accident in 1969, on his birthday, made him a paraplegic—class A for the rest of his life. His pension when he was discharged was roughly, on the figures that were presented to the High Court, about $5,000-odd in those days. That figure today, if he was still alive—Fred died two years ago, unfortunately—would be $44,000. That was for a person who had a capability and was recruited on his expertise. He was injured in the course of his duty. He could not bail out of a vampire jet and was made a paraplegic. He had his career ahead of him. He could have gone anywhere. He did not.

ACTING CHAIR—Thank you very much, Mr Wade. We appreciate that you have actually provided some details on Lieutenant Goodfellow's circumstances because it does give us a very clear indication of the kinds of people that you are advocating for here today. We do appreciate the fact that you have come, particularly from Western Australia, to appear before us.

Senator WEBBER—It is a long way, isn't it?

ACTING CHAIR—It certainly is.

Senator WEBBER—I am from Perth. It is a long way.

ACTING CHAIR—It is great. Commodore Adams, you were trying to get your finger in?

Cdre Adams—I am just trying to wind it up and say thank you to the committee for hearing us. As we have indicated, there are issues on the periphery of this, but the one we think really ought to be focused on is this question of class A invalidity. Flowing on from that, of course, is the issue of the widows and families and those who follow. I think that very often we forget the widows. If you consider tragic things like the *Voyager*, there would still be the widows out there who are receiving a reversionary benefit from that. Those are the people we should really be looking after. I think that if it was good enough for the High Court to recognise that class A should be tax exempt then it is time that we fell in line. I thank you for your time. These issues on the various military pensions are complex and you would probably find that there are some going back as far as deferred pay. Thank you for your attention. But if we can get the class A invalidity pension through, we have done a great job. Thank you.

ECONOMICS

Senator JOYCE—I was next door at another committee hearing, but I am very interested and I have read all of your submissions. I will be following it through.

ACTING CHAIR—We did discuss a few pieces of information that you might be able to provide later to the committee. If there are pieces of evidence that you want to submit to the committee, we would appreciate them. We would need them fairly quickly as the report is actually due to be tabled on 7 February. But perhaps there are figures or some examples out of the UK or the US experience that are relevant to our discussions. Thank you very much.

[2.35 pm]

DAVISON, Mr Michael, Superannuation Policy Adviser, CPA Australia Ltd

KELLEHER, Ms Noelle, Member, Financial Advisory Services Centre of Excellence, CPA Australia Ltd

FORSDICK, Mr Michael James, Partner, PricewaterhouseCoopers, and representative, Institute of Chartered Accountants in Australia

ORCHARD, Mrs Susan Janet, Superannuation Technical Consultant, Institute of Chartered Accountants in Australia

ACTING CHAIR—I welcome you to this hearing in relation to the Tax Laws Amendment (Simplified Superannuation) Bill 2006 and five related bills and remind you that the evidence you give to the committee is protected by parliamentary privilege. Do you have any comment to make on the capacity in which you appear?

Mr Forsdick—I am a partner with PricewaterhouseCoopers, specialising in taxation and particularly superannuation. I have come along here today representing the Institute of Chartered Accountants in Australia.

Ms Kelleher—I am the National Director, Superannuation, for Ernst & Young, as well as being a member of CPA Australia's Financial Advisory Services Centre of Excellence.

ACTING CHAIR—I invite you to make an opening statement.

Mr Davison—I would like to thank the committee for the opportunity for us to appear before it and give evidence. You have our submission, so we will keep this brief. There are two key points I want to raise. Firstly, CPA Australia certainly welcomes and strongly support this package of simplification. We believe it is a significant step towards improving the super system and, importantly, increasing retirement savings. In particular, the removal of taxes and the reasonable benefit limits, we believe, will improve retirement savings in the long term. The simplification of the payment rules and the remaining benefit taxes, we hope, will make super easier to understand. Ultimately people's engagement with super will increase over time, and their participation will increase. We are pleased with the improvements to the treatment of the self-employed and the greater equity in how their contributions are treated as far as deductibility and having access to the government co-contribution are concerned.

On the other side, we still have some concerns about some aspects of the package. We believe that more could be done to improve equity and truly simplify the super system. Our concerns, which are spelt out in our submission, centre around the taxation of death benefits to nondependants, the ability to commute existing complying income streams, the treatment of overseas super benefits in respect of the contribution limits, some of the transitional contribution limits to do with concessional contributions and, as the last group were discussing, the treatment of untaxed benefits. We also believe that the introduction of this significant reform to the system gives us an opportunity to further refine the system. In that respect we believe that allowing for full deductibility of all super contributions will go a long way towards that. That wraps it up. We are pretty much open to questions from the committee.

ACTING CHAIR—Thank you for your submission. It is very useful to hear from the accountants' side of the table when we have had industry appear before us this morning. I am going to move straight to questions.

Senator SHERRY—As you were not here this morning, I will not assume that you are aware of the evidence from ASFA and IFSA in particular and also Mercer. I thought I would start with the issue of the tax file numbers—we explored that in a fair amount of detail this morning—and the difficulties that are presented in collecting them, and then the new tax regime that will apply—the 46.5 per cent, I think, versus 15 per cent on contributions. Do you have any observations to make about this issue?

Mr Davison—Probably a couple of points. From discussions with people in industry funds, I know that there is a lot of concern that they already have difficulty in getting tax file numbers from their members, and they have run considerable campaigns over the years to try and increase coverage. I understand something like 30 per cent of the members of one big industry fund have not provided tax file numbers. One anecdotal thing I have heard from industry funds is that many employers feel they are not in a position to pass on tax file numbers. They believe that the way the current form and the rules work is that they are not physically allowed to pass them on. There is probably a need for an education campaign or greater understanding of their role.

The second issue is that funds have been trying to get tax file numbers for years and still have quite a considerable rate of noncollection, for want of a better word. It is fair enough that you should have tax file numbers as an identifier. I think that is a reasonable approach. I think we are going to need a strong education and communication campaign from the government and the funds to members, employees and employers. But I think the biggest thing that would help would be for the tax office to free it up to pass on tax file numbers to the funds. I have no idea what the number is but I imagine the tax office has quite a considerable proportion of people's tax file numbers now. If we can loosen privacy provisions somewhat so that they can pass them on to funds, I think a lot of this problem will go away.

Senator SHERRY—On that matter, I did ask the tax office about this last year and they estimated that 76 per cent of TFN numbers are held by super funds. There is obviously considerable variance across funds. They themselves hold a further seven per cent, bringing the total to 83 per cent. If we assume that the ATO are able to add in their seven per cent, we get to 83. You refer to education. Isn't it a fact that the funds at the moment do extensive direct communication with members on this very issue and we are at 76 per cent?

Ms Kelleher—The funds do a lot of education but it probably needs to be more basic education coming from the tax office or some independent body because a lot of people's immediate concern, when the funds say, 'Here, give me your tax number,' is suspicion. They think, 'Why do I need to give you something that you don't need to know?' A lot of people do not appreciate the fact that from the super perspective it works to their advantage for the funds to know their tax file number. It might be just a simple campaign on the television that happens for however many weeks asking, 'Have you given your super fund your tax file number?' That way it would not be the funds that were saying it; it would be the government, the tax office, ASIC or whichever body was considered appropriate. It would be a way of raising individuals' awareness that they need to do something to look after their super.

While it would be nice to have a system that was totally foolproof and with no problems, we also have to work on the basis that individuals do need to take some responsibility for how their super is treated. For a lot of people it is going to be, if not their most significant asset, their second most significant asset. Therefore, they do need to take some ownership, and a simple campaign may do the trick.

Senator SHERRY—Sure, that is a great theory, Ms Kelleher, but super is compulsory by government policy in this country because people do not take responsibility. The fact of life is that people would not save in super for their retirement unless it was compulsory. That is the very nature of the policy. Therefore it brings in a group of people—and I thought Mercer's submission was quite interesting, if you have a chance to look at that—who, because of that inertia—to compulsion you add inertia—simply fail to fill in forms, for example, with very basic information.

Ms Kelleher—Yes. That is where the compulsory opt-out systems are better than compulsory opt-in systems. It gets back to the whole question of adequacy, voluntary super and all the rest of it. It is actually setting up a system so it works. The way to do it is to set it up so that you have people opt out to do something you do not want, as opposed to opting in to do stuff that you do want. So it may be that it has to be made really clear to the employers and to the employees that 'Your employer must give your TFN,' so you do not have the frivolous litigation issues of 'You've passed on information that you shouldn't have,' et cetera and so that the employees are actually signing to say, 'I don't want you to pass it on to the super fund,' as opposed to having something where you are asking them to opt in. It is all about setting it up to work the way we want it to, as opposed to the other way.

Senator SHERRY—Yes. If we had an opt out, where the individual—or the employer—is told when they sign their form, 'You can opt out of the tax file number provision, and this is the consequence,' it does then beg the further question: if the employer then fails to provide the tax file number to the superannuation fund, why should the employee pay a penalty? The employee has said, 'Look, I want you to provide it; I'm not opting out,' and the employer has failed to provide it to the fund—and that happens at the moment, as I understand it.

Ms Kelleher—Yes.

Senator SHERRY—Some employers do fail to provide it. The employee is then penalised.

Ms Kelleher—That is where you would look at whether you have a system whereby the super funds have their letter to the new member which says: 'Welcome to your fund. I have received this contribution for you. By the way, the employer has not provided me with your TFN. Do you want to provide it?'

Senator SHERRY—Yes, but if the employer is authorised to provide the tax file number, the principle of then penalising the employee with a massive tax increase on their contributions just seems to be a bit odd to me.

Ms Kelleher—I suppose what you are looking at, though, is that potentially that penalty is happening a bit down the track. I am not saying that it is absolutely happening down the track, because you would get to 30 June and you could have contributions going on 30 June that might have ramifications and all the rest of it from that perspective. But I think that—if we look at how many safeguards we can put in there—really, at the end of the day, saying,

'Employee, you've got to take some responsibility here,' should help to get us over the line. And maybe you have a system in place as well such that, if the employee is getting a penalty and it is actually the employer's fault, the tax office has some discretion to then seek that penalty from the employer or to increase the charge or do something of that nature. This whole new system hinges on the tax file numbers. If we do not have something in there that encourages people to or makes people give their tax file numbers to the super funds then this whole system just does not work.

Senator SHERRY—Sure, it is a great theory, but you are the informed. You are a person who takes an interest—indeed, all the witnesses do. We have millions of people at the moment—5.8 or 5.9 million, I think—who are classified as 'lost', who do not fulfil one basic requirement, which is to provide an up-to-date address. We have lots of campaigns. The government has run three or four publicity and media campaigns on that issue alone in the last 10 years, and the numbers still increase.

Ms Kelleher—I think you would find, though, on people's general knowledge about superannuation, even just with the media coverage that has been happening of late, that even the young kids know far more about superannuation than people did 10 years ago. I am not saying that we will ever have a situation where we will not have lost benefits or anything of that nature, but I think we also have to give people some credit that their awareness is increasing.

Senator SHERRY—Yes, I give some people some credit, but I am particularly concerned about a penalty regime that will apply to a group of people. Realistically, are we ever going to have 10 million people who understand the superannuation system?

Ms Kelleher—I won't make any comment!

Senator SHERRY—If they did, you would be out of a job and so would all of the planners in the country. But I am sceptical about whether we are ever going to reach that level of interest or literacy.

Ms Kelleher—With the TFN penalty regime, you can give the tax office some discretion. If the individual can show that they authorised the employer to pass on the tax file number and the employer did not, the penalties then go to the employer.

Senator SHERRY—Not to the employee?

Ms Kelleher—And not to the employee. That could be set up quite easily. It does raise issues such as what if the employer has gone bust and all the rest of it. We can think up millions of reasons why it will not work. But that would be a way of getting it so that at least you could shift the penalty from the individual to the employer.

Mr Davison—I think it is worth keeping in mind that with the tax file number regime to date from 1997, which was when it came in, there has been no strong compulsion to quote your tax file number. The only time you were penalised was when you actually had a benefit paid out to you at the other end. I dare say there was also inertia in that respect—'I won't quote it until I need to.' Going into this new regime, if we actually run some pretty strong campaigns in the media saying, 'If you don't quote your tax file number to your super fund, you will lose over half of your contribution or half of your benefit before it even gets there,' I

dare say we will have a stronger take-up. I agree that it is unlikely to get 100 per cent, but I still think it will be a much more immediate call to action than we have had in the past.

Senator SHERRY—Sure, but my concern is this. I do not think anyone is suggesting that we will get 100 per cent. Let us say that we get 95 per cent, which is a vast increase on the current 76 per cent to 95 per cent. We can get the seven per cent that the tax office holds and put them into the system. Five per cent of 10 million is still half a million people paying a whacking great tax on their super contribution. This is all about reducing tax on super, not increasing tax on super, isn't it?

Mr Davison—Yes.

Senator SHERRY—Even one per cent is 100,000.

Mrs Orchard—One of the features of it is, though, that it is recoverable. So, when you do correct it, you can recover that tax.

Senator SHERRY—Just as lost super is recoverable. We have 5.7 million or 5.8 million accounts, increasing at the rate of one million a year. It is all recoverable if they fill in a form, isn't it?

Mrs Orchard—Part of the problem with lost super is also the definition. I think that you can go into some different issues there. But, with this system, it is recoverable. I guess my concern also comes from a different aspect. In the first few years, while we get that additional 20 per cent of tax file numbers, there are going to be reverse workflows and some costs there. We need to perhaps put some caps on or make levels under which we say that these contributions are too small and the penalty of halving it would be too harsh, because they are not likely to be people who are getting near the high-end caps—the group that you are trying to penalise and the reason why tax file numbers are there. I was actually looking at it from perhaps some different perspectives. There are numerous options to alleviate some of the tax issues in the short term but still get the compulsion of tax file numbers occurring. I think they should also be considered.

ACTING CHAIR—We had evidence this morning from some of the fund representatives suggesting that five months is not long enough to actually get this regime in place and suggesting an extension of an additional 12 months—that having the regime come in on 30 June 2008 would be a more appropriate time frame. Do you have a response to that?

Ms Kelleher—I would not underestimate the amount of systems work, publication work and website work that the funds actually have to do between now and 30 June, even just in terms of getting some of the basics up and running. Anything that would give the funds a little bit of breathing space I think would work in everyone's favour, including the funds' own campaigns in terms of collecting the TFNs et cetera. We should not underestimate the amount of work that the funds have to do to get this whole system in place from go to whoa.

Mrs Orchard—And also the consumer. There are people who may want to make the additional contributions as allowed by 1 July 2007. There are those who may want to consolidate benefits in order to be able to make the most of their pre-1983 components. That all takes time and resources. It is the same funds which are going to have to implement major system changes and which are also going to have to be dealing with increases in perhaps

benefit payments or contribution receipts and things like that as well. We have layers of additional pressures there in the period up to 1 July 2007.

Mr Davison—I think it is a difficult issue because, on the one hand, we have retirees who are going to get a definite benefit from this after 1 July, be it a reduction in tax on their pensions or, if they take a lump sum, the fact that it will be effectively tax free. People are already changing or postponing their retirement decisions based on the fact this is coming in from 1 July. So they are going to get a definite benefit. The other side is that the funds, as Noelle said, are going to struggle to be ready for this on 1 July. I think one of the key issues for the industry is to have a settling-in period where possibly penalties and regulation are not as harsh as they could be, to allow for the fact that everyone is getting the hang of this. The average person is going to have to get the hang of the new contribution limits, how they can take the benefits et cetera. So it is going to take at least a couple of years until we all settle into this system. There needs to be a fair bit of leeway for everyone involved until we get it right.

Senator BERNARDI—In circumstances where people are penalised for not providing information like a tax file number—such as upon employment, when they are taxed at the highest marginal rate if they do not provide a tax file number—or an ABN in the case of GST, if you are doing dealings like that, do you have an estimate of the number of people that choose not to supply that information and suffer that penalty?

Mr Davison—No, unfortunately we do not have that information. I am sure it is available. I imagine the tax office can provide it to you, but we have not seen those numbers ourselves.

Senator BERNARDI—Would it be a minority like less than 10 per cent?

Ms Kelleher—Anyone who is trying to do the right thing will always give you anything that you ask for. I suppose it is more an issue of what they are trying to hide if they do not give it to you—or it might be an administrative oversight. But most people are out there trying to do the right thing and trying to give people all the information that they have seen. I have never once, in all my years of working, had one of my clients say to me, 'No, I won't give you my tax file number,' or 'I won't give you my ABN,' or whatever it is that I am asking for. I suppose I am dealing with the top end of the market, which means that I do not necessarily get to see a lot of people who might be iffy about giving the information, but most people will give it to you if you ask them and if you explain why you need it.

Senator BERNARDI—The reason for my asking is simply that we have had a lot of talk about the provision of tax file numbers and it is obviously an issue. Sometimes tax file numbers are not provided through apathy, but there is some genuine noncompliance, with people using fictitious names for superannuation accounts. In your opinion, are we making a bit more of it than should be made, given the fact that most people do the right thing when they are faced with financial penalties and as long as they have the opportunity, through communication from the funds or through additional pressure put on employers to supply the information in a timely manner? I wonder whether the noncompliance rate might be a great deal less than we are expecting. Do you have a comment or a thought on that?

Mr Davison—I think it is the great unknown. It is a change in the regime. It is going from there being no great immediate compulsion to there being a compulsion to do it straightaway

or you will be penalised. Time will tell. It is a crystal ball job as to whether we are going to know from day one. Effectively we have 12 months for people to get their tax file numbers in before they started getting penalised. There may be a question as to whether that is long enough or whether it should be longer. From a fund point of view, they will hopefully start getting a feel for where it is going in the first 12 months. Maybe we need provision for extending the period if the collection is not happening, if people are not submitting their tax file numbers. Senator Sherry has concerns about a percentage of people still not giving it. Maybe we need to see how it progresses and then decide whether this is going to work or not before we start penalising 10 or 15 per cent of the workforce because they have not given their tax file numbers.

Ms Kelleher—Yes, but having a mechanism where the penalty could be shifted from the employee onto the employer would certainly go a long way, I think, towards alleviating the issues of however many people who might find themselves in the position of 'I've done the right thing, but it's my employer who hasn't'. If there is a discretionary mechanism or a penalty mechanism where you could lodge submissions with the tax office to say, 'Look, here's my form where I've ticked "give my number to the super fund" et cetera,' and the employer has not done so, that would go a long way towards alleviating a lot of the issues.

Senator SHERRY—I am concerned about your earlier statement, Ms Kelleher, where you said, 'I've never had anyone refuse to provide their tax file number or ABN.' That is in the context of those people, if they do not provide it, getting whacked appropriately. Their tax is affected—that is, the money they are receiving is affected. It is a different issue with super: people are not immediately losing money. They do not collect that money till they reach retirement age, whereas with nonprovision of an ABN for income tax purposes there is a very immediate penalty that they feel straightaway.

Ms Kelleher—I think that is where we have to look at how many safety measures we can put in that actually give the opportunity to make sure that either penalties do not get imposed or there is a way to claw them back.

Senator BERNARDI—Just coming back to this issue, I still find it difficult to reconcile that the employer would send off information to establish an account on behalf of an employee and either through negligence or vengeance withholds a tax file number, and then the fund would write to the employee, saying, 'We haven't got your tax file number; can you please provide it,' because you are looking at a complete loop of neglect if no-one supplies it at any stage of that cycle and people's attention is not drawn to it. I give the Australian public a bit more credit than that, I guess. Given the circumstance of compulsion, if people received a letter saying, 'You're going to be paying 50c in the dollar on tax on your superannuation and it is going to directly cost you such and such,' I think they would respond to that. But I am only guessing.

Ms Kelleher—I think that is right too, but in anything to do with superannuation there is always going to be the odd bunny who does not quite get it or does not quite get it right.

Senator BERNARDI—In anything to do with anything, there are always going to be people who don't quite get it!

Ms Kelleher—But if there are enough checks and balances in there I cannot see that we would not capture the vast majority of people. I won't say all of them, but I would say the vast majority.

Senator BERNARDI—Okay. Thank you.

Mrs Orchard—The message is as clear as that: 'You need to provide your tax file number; the consequence of not doing so is this dollar cost or this percentage cost.' If we get too wound up in lots of explanatory information, people won't read the letter and return the form.

Senator BERNARDI—Particularly if it was targeting employers: 'You need to provide this for your employee which they have authorised, and you contact the employee themselves.' Anyway, I would be a bit more optimistic about the results than others perhaps.

Mrs Orchard—I think we need to be very clear in our messages in any education.

Senator SHERRY—Yes. I do not know what the proportion of superannuation funds that do not have members' current addresses is, but that again is a practical communication issue. A substantial proportion of lost super accounts—whatever the concerns about definition—are lost because there is no current address. So you add one problem on top of another problem.

Ms Kelleher—The other side of the coin is that, if we do not have this mechanism in the system, I can tell you there will be far more people who rort it than people who are penalised with the high tax rate. That is the other side of the coin. If we do not have a system where people have to give their tax file numbers and there is no penalty for not doing so, there will be far more people who will just give their money to their super funds—and it won't be little dollars; it will be big dollars because no-one is going to track them down.

Senator BERNARDI—Of the 17 per cent of super funds that do not currently have tax file numbers—I have heard varying figures, but I think it is 17 per cent—what is the estimate of the number of rorters: the Jim Beams, the Johnnie Walkers, the Father Christmases, the Elvis Presleys and whoever else?

Mr Davison—It is probably not an issue now, but going forward, given we have contribution limits of $50,000 and $150,000, if we did not have checks you could easily set up your Elvis Presley account and your Santa Claus account, and put $50,000 in a year and get around the limits. We do not have that problem now.

Senator BERNARDI—Thank you.

ACTING CHAIR—Can I come back to the institute submission. You raise an issue that we have not actually seen in any of the others. It is about the removal of the temporary absence rule and the residency test. Would you like to elaborate on that?

Mrs Orchard—When we received the bill, there was a change in some terminology and that has seen the removal of the temporary absence test. We have not seen anywhere that it was an intended policy change. It could just be that it was a drafting oversight and that it will get amended in the consequentials. If we are changing the definition of a resident, the concern is that, come 1 July, there will be people who have been working under an old definition who are now nonresident and have to do something with their funds. How we educate them will become an issue given they are nonresident.

The other concern is that the test is more a case of 'ordinarily', so it becomes a touchy-feely test rather than a pragmatic case of 'these are the rules'. In order to implement the rules, we need a lot more guidance around how they will work so it does not become subjective. We are looking for something which is more of an objective test. We are looking for clarification as to whether that was an intended or unintended consequence. I guess if it is unintended, it should be corrected.

ACTING CHAIR—Thanks.

Mr Davison—We have raised this with Treasury as well. The difficulty is that it appeared out of nowhere in the bill. It is a departure from the existing arrangement. The two-year rule on residency and control of the fund in Australia, whilst not ideal, is at least a definitive benchmark of what you need to meet to satisfy your residency requirement. If we remove it, it is suddenly open to interpretation and touchy-feely, as Susan mentioned. It will actually put the tax office in a difficult position whereby they will have to interpret what it all means and set up rules and guidelines as to how they make determinations. It will actually make it more difficult to police than it is now. Having raised it with Treasury and the tax office, we think it is probably a drafting error and we hope that, as Susan said, it will be corrected in the consequentials. We will wait and see.

Mrs Orchard—One of the issues is that if I am currently an expat overseas and I have Australian based superannuation money, I can put it into a retail sector fund or a large fund where the central management and control is in Australia, and retain my moneys in that system. If I have it in an SMSF—and this is really the area where this has an impact—then I must move my money out of that system if I no longer meet the residency test. Moving it over to the retail sector, I am not removing myself from any of the advantages of having money in the Australian superannuation system; I am merely moving the entity which is holding that money. As long as we have a clear definitive rule upon set-up, whether or not that remains in place on an ongoing basis does not actually change the outcome for the individuals. We have far better communication now than we did 10 years ago when definitions like these were introduced. The purpose of having rules such as these is perhaps not as necessary as it once was. That is another reason not to have a more difficult rule to deal with.

Ms Kelleher—One of the things that we need to recognise with anything to do with superannuation and overseas issues—that is, people going overseas, people coming back to Australia, benefits coming into Australia or whatever—is that quite often these people who are moving in and out of Australia are doing it on no more than 30 days notice, or 60 days notice if they are lucky. Certainly, in the corporate world, if you are told you have to get from Australia to New York or from Singapore to New York in 14 days—and I have had that happen to a cousin of mine, so I know that it happens—the last thing on your mind is your superannuation, particularly if you have to pick up your children and your wife and you have to get rid of one home, set up the new home and get yourself organised. Anything that we can do with the super rules that gives people time to think about their superannuation in an orderly fashion will be important.

It will be more important with the self-managed super funds, because I think that the market is going to polarise. People in their 20s who set up a self-managed super fund, be that the right or the wrong answer at that point in time, will not know that in their 40s they are

going to be shipped off to wherever with 30 days notice. So we have to make sure that these people have time to make prudent decisions about their retirement money. Anything that creates a greyness or that becomes a black-and-white rule that says: 'This is your time period and you have no time to think about it,' or whatever is going to be detrimental in the long run for Australians, particularly when we are looking at a globalised workforce, and we have to deal with the issue that these things happen.

Senator JOYCE—I have one query. You probably read in the submissions about the issues that were brought up by former members of the Defence Force about pre-1988 contributions. Have you had a chance to touch on them at all?

Ms Kelleher—Yes. I suppose you have two issues. You have the unfunded liabilities, which may be liabilities that exist even today, be it as pre-1988 or pre-today contributions. Then you have pre-1988 issues. I think what the people who appeared before the committee were more concerned about is the unfunded liabilities. From my perspective, speaking as Noelle Kelleher, I am concerned that there is a sector of the superannuation retirement group which has unfunded liabilities, that effectively have RBLs by another name. I can understand that there has been no contributions tax on their benefits—that the money is flowing into the fund and then flowing out to them. And, yes, there is a need to look at contributions tax issues. But I cannot see why they have end benefit tax issues and effectively RBLs by another name. It just seems totally inequitable that one part of the retirement sector has RBLs and another part has not.

Senator JOYCE—I am asking for your collective professional advice. I have read about it myself and there was something that jumped out and said that their position is flawed. It seems that they have a realistic expectation that that should be changed. Would you have the same expectation?

Mr Davison—I think the association's official view very much reflects Noelle's personal view. As far as unfunded benefits are concerned, fair enough, you have not paid contributions tax on the way in, as someone in a funded scheme or a taxed scheme has. So, yes, you should pay some sort of tax on the way out to compensate for that. But any tax regime on unfunded benefits should recognise and replace that forgone tax on the way in. We end up with a system now which has been pretty much left alone. We have not really made any substantial changes to how these benefits are taxed. All we have done is to change the taxation of tax benefits or take the taxation away.

On top of that, as Noelle said, we have removed the RBL and replaced it with a flat-dollar limit whereby, above that, you are taxed at a higher rate. That higher tax rate does not compensate for the contributions tax that you have not paid. It is a penalty tax. So, essentially, we still have a regime where these people who are in unfunded schemes—not necessarily by choice; they may actually have forgone other opportunities and benefits by being in these schemes—continue to be penalised greater than they should be. Our position is that there should be some compensation for this tax, but it should be something quite simple. We do not understand why we have this de facto RBL.

I guess the third impact, as well as your income still being assessable income from an unfunded scheme, is that there is potential to push you up into higher tax brackets, which you

do not get with a taxed fund. You have a Medicare levy on your benefit, which you do not get with a taxed fund. Also, there is potential to exclude you from other benefits because you have a higher assessable income. We agree there is a need for it, but we do not agree that this is an equitable solution.

Senator JOYCE—It should be more commensurate with what has possibly been lost rather than—

Mr Davison—Yes.

Ms Kelleher—The other side, too, is that quite often these people have put in their own personal contributions all the way through, whereas, if you look at a lot of the taxed arrangements, you will see there have been no personal contributions. So they are almost being penalised on the way through. They have to put in some more money that other people don't, and yet when the money is coming out they are also being hit around the head on that side.

Senator SHERRY—They shouldn't be when you consider the fact that, compared to community standards, there is a very high employer contribution.

Mr Davison—That is true, but I am not that familiar with Defence schemes.

Senator SHERRY—From a general public sector—

Mr Davison—From the public sector side, salaries tend to be lower than what are often available in the commercial world. I dare say the higher employer contributions are probably compensating for the lower salaries. I suspect overall packages are quite similar or still less than what you would get in the commercial world. I am not sure that you can look at employer contributions in isolation and say that, because they are greater, you are getting a greater overall benefit.

Ms Kelleher—I have certainly done some work over recent years where we have compared the private sector with the public sector: what is the annual remuneration in the private sector and what is the superannuation and how does that compare with the public sector? What we looked at did not show that the super on one side or the other side was grossly out of kilter et cetera. I think what the public sector is forgoing in terms of current annual income is very true. That might make up for some of the increase in their superannuation, but it certainly is not pushing the numbers totally out of whack with each other.

Senator JOYCE—Thank you.

ACTING CHAIR—I thank all of you for your evidence this afternoon. It has been very helpful to us.

Proceedings suspended from 3.18 pm to 3.41 pm

BONEHAM, Mr Patrick, Specialist Adviser, Superannuation, Retirement and Savings Division, Department of the Treasury

GALLAGHER, Mr Philip, Manager, Retirement and Income Modelling Unit, Department of the Treasury

RAY, Mr Nigel, General Manager, Tax Analysis Division, Department of the Treasury

THOMAS, Mr Trevor John, Principal Adviser, Superannuation, Retirement and Savings Division, Department of the Treasury

FORSYTH, Mr Stuart, Assistant Commissioner, Australian Taxation Office

PETERSON, Mr Brett, Assistant Commissioner, Australian Taxation Office

VIVIAN, Ms Raelene, Deputy Commissioner, Australian Taxation Office

ACTING CHAIR—I welcome representatives of the Department of the Treasury and the Australian Taxation Office. Before we commence I want to recap a couple of issues for the benefit of the officers. If a witness objects to answering a question, that witness should state the grounds upon which the objection is taken and the committee will determine whether it will insist on an answer having regard to the grounds which are claimed. If the committee determines to insist on an answer, a witness may request that the answer be given in camera. Such a request, of course, may also be made at any other time. Any claim that it would be contrary to the public interest to answer a question must be made by a minister and should be accompanied by a statement setting out the basis for that claim. The Senate has resolved that an officer of a department of the Commonwealth or of a state shall not be asked to give opinions on matters of policy and shall be given reasonable opportunity to refer questions asked of the officer to superior officers or to a minister. This resolution prohibits only questions asking for opinions on matters of policy and does not preclude questions asking for explanations of policy or factual questions about when and how policies were adopted. Do you have an opening statement?

Mr Thomas—We will not be making an opening statement. I want to thank the committee for the opportunity to appear and answer questions on the submissions. We are happy to take questions.

ACTING CHAIR—Thank you very much. We have had a very interesting day in terms of the evidence that has been presented to the committee. We have had some very strong submissions that I am sure you have had an opportunity to examine. This afternoon we had representation and some very forceful evidence from the Regular Defence Force Welfare Association in relation to their submission, so I know that there are questions from all of the senators about the issues that have been raised.

Senator SHERRY—I want to go to a couple of new issues that have arisen since we last met at estimates and since the May budget announcement and—I cannot recall the exact date—the release of the details for implementation after consultation. The new issues were those that were in the press release from the Treasurer and the Assistant Treasurer of 7 December. The first of the new issues was the change to unclaimed money arrangements. It is outlined in the proposal—and I note that it does say 'proposal'— that unclaimed moneys will

at some future date be paid to the Commonwealth rather than to the states and territories, except for state and territory government superannuation schemes. It says it is a proposal. Where is this up to? Is it to be reflected in legislation to the parliament?

Mr Thomas—Yes, that is correct. It is going to be reflected in legislation. It is intended to include this particular measure in the consequential amendments bill, which is being prepared at present and is scheduled for introduction into the parliament in the first sitting week.

Senator SHERRY—That is next week.

Mr Thomas—Correct.

Senator SHERRY—I am trying to recollect—I think it was 1997 or 1998—when unclaimed moneys were handed to the states. I cannot recall the exact date, but I think it was about 10 years ago when the moneys were passed to the states in this area.

Mr Thomas—I think it dates back to the commencement of the Superannuation Industry (Supervision) Act and arrangements that flowed on from that. As part of the arrangements for implementing the SIS legislation there was, you might recall, a heads of government agreement entered into between the Commonwealth and each of the states. What the heads of government agreement related to essentially was that schemes that were administered by the states were to follow the rules of SIS without formally being regulated under the SIS Act. As part of the negotiations with the states over that process, the government took a policy decision at that time to have unclaimed moneys paid to the state in which the superannuation fund concerned was headquartered.

Senator SHERRY—I certainly recall it was to be paid to the state, but I thought it was later than that.

Mr Thomas—It may have been.

Senator SHERRY—Could you double-check that?

Mr Boneham—I think you are referring to the 1997 bill, which moved the provisions which were in the SIS Act into their own separate act. There was no policy change; it was just a decision to put them into their own separate act.

Senator SHERRY—Presumably you have an estimate of the moneys that would be paid now, or from whatever the operative date is, to the Commonwealth rather than the states or at least an estimate of the actual moneys that have been paid to states and territories over the last couple of financial years.

Mr Ray—As in the amount of unclaimed moneys that funds have paid into the states on trust?

Senator SHERRY—Yes.

Mr Ray—I do not have an estimate of that with me.

Senator SHERRY—But presumably you would have had an estimate in order to put together this proposal at this stage.

Mr Thomas—The proposal at this stage relates to the future unclaimed moneys.

Senator SHERRY—I understand that.

Mr Thomas—The stock that is in the states is something that relates to discussions at the moment between the Commonwealth and the states.

Senator SHERRY—How do you mean 'the stock'?

Mr Thomas—At present moneys have been paid to each of the states as unclaimed over the last decade. That is held by the states. What happens to that money is something that is still in the process of discussion between the Commonwealth and the states. The revenue impact that you are talking about is looking forward.

Senator SHERRY—Correct. But I was going to what were the actual figures over the last, say, three or four financial years. I am sure you have looked at them to see what the actual quantum of money is that is likely in future.

Mr Ray—I have not looked at them. If you are asking what the effect on the budget balance is going to be, we publish that in MYEFO, and the estimate that we have at the moment over the forward estimates is nil.

Senator SHERRY—So there is no gain?

Mr Ray—No gain.

Senator SHERRY—I am a bit perplexed as to why you say there will be no gain, because there must be some moneys that are unclaimed that the Commonwealth is now going to retain and will never be claimed by the individuals involved.

Mr Thomas—Essentially there will be an inflow and an outflow; that is the expectation.

Senator SHERRY—Will the outflow equal the inflow?

Mr Thomas—One of the reasons for doing this is to make it easier for people to reclaim the money, because at the moment it is very difficult for people to be certain where they need to go in relation to claims.

Senator SHERRY—I understand the rationale.

Mr Thomas—We expect there will be a high take-up.

Senator SHERRY—I understand the rationale; I am just trying to get to the actual figures.

Mr Ray—On an accrual basis the inflow will equal the outflow.

Senator SHERRY—So you are not expecting any net gain to the Commonwealth?

Mr Ray—No.

Senator SHERRY—Even with lost moneys now up to $9.7 billion?

Mr Ray—On an accrual basis, no.

Senator SHERRY—Why do you believe that will be the case?

Mr Ray—I think the way the accounting works is that when the revenue is received the liability is incurred at the same time.

Senator SHERRY—But what if not all the money, the revenue, is claimed? It goes into government consolidated revenue.

Mr Ray—That would affect cash.

Senator SHERRY—What is the effect on the cash, then?

Mr Ray—I would need to take that on notice.

Senator SHERRY—Okay. There must be some cash gain to government revenue. It might be $10, $10,000 or $10 million but there must be some gain because, presumably, some of these moneys are with other unclaimed moneys—bank accounts, Lotto and all that sort of thing—aren't they?

Mr Thomas—Yes, they will be.

Senator SHERRY—Another section of the press release, under the heading 'Additional information', says:

... the Government will consider amendments to Part IVA of the *Income Tax Assessment Act 1936* to ensure that superannuation-related avoidance is dealt with appropriately.

What are the sorts of avoidance activities under examination in this context?

Mr Thomas—In the process of consultation it became apparent that certain players out there, particularly wealthy individuals, recognise the attractiveness of the superannuation system with the government's reforms and are looking at ways to exceed the caps that are included in the government's legislation. It was pretty apparent from the evidence that we were getting from industry players that they would be examining the law very closely to look for any loopholes or any opportunities to exceed the caps that are very clearly stated in the government's announcements, and they would be seeking to exploit those opportunities. The government announced in its press release that that indication was coming to them and they would be looking to clamp down on those to ensure that the integrity of the system was maintained.

Senator SHERRY—Have any amendments to the Income Tax Assessment Act been identified yet? Will we see amendments shortly?

Mr Thomas—No, not at this stage. I think they will be examining the provisions that are passed and then looking at what needs to be done and the opportunities to exploit those provisions. It is something that the tax office will be keeping a close watching brief on, and we will be briefing government when those issues come to our notice.

Senator SHERRY—It seemed strange to me that one of the issues I was informed about should occur—I am not sure of the efficacy of it. It is the situation of a person resident in the United Kingdom contributing to the United Kingdom private pension system and paying income tax in the United Kingdom—a former Australian resident. Apparently, they would be able to contribute money in the UK and also into the system in Australia. It may well be that that is regarded as reasonable, but can you clarify that for me? So they are in the UK paying tax but contributing to an Australian superannuation fund and a UK pension fund.

Mr Boneham—I understand that there are no restrictions on who can contribute to a super fund, but I imagine that you will get to this issue sooner rather than later. If they do not have a tax file number, they will not be able to make any undeducted contributions to that. Also, if they do not have a tax file number, firstly they will be subject to the concessional cap and secondly they will be subject to the no TFN tax as well. Just because they are a non-resident it does not mean that they get around those caps.

Senator SHERRY—Anyway, there will be some interest in that. I just want to come to the issue of the revenue and expenses tables that were attached to the press release. On the revenue side, it has the total loss of revenue in the out years. In which areas is there a cost to revenue within that total of revenue forgone?

Mr Ray—Do you mean which revenue head? Is that what we are talking about?

Senator SHERRY—Yes.

Mr Ray—It is principally personal income taxation—so ITW individuals and total withholding.

Senator SHERRY—Are there any others?

Mr Ray—In terms of the loss to revenue?

Senator SHERRY—Yes.

Mr Ray—Other individuals and refunds—the components of personal income tax.

Senator SHERRY—What about gain to revenue?

Mr Ray—There are gains to revenue to super fund head and companies.

Senator SHERRY—If we just deal with gains to revenue, with super fund head, what measures lead to a gain to revenue?

Mr Ray—It is the package as a whole. We are expecting that there will be an increase in contributions in earnings tax.

Senator SHERRY—So presumably you have examined some component behavioural change that will result in an increase in super tax under the super tax head—contributions tax, for example?

Mr Ray—That is correct.

Senator SHERRY—Do you have the estimated breakdowns of those figures?

Mr Ray—I would need to take that on notice.

Senator SHERRY—I am sorry—that is not what I am asking. Do you have estimates for those categories?

Mr Ray—Not with me.

Senator SHERRY—That is not what I am asking. Do you have estimates of those categories?

Mr Ray—Revenue does, yes. The estimates in the Mid-Year Economic and Fiscal Outlook included a breakdown of the package by revenue head. So it is allocated to the individual revenue heads in MYEFO.

Senator SHERRY—There are a lot of broad questions around the issue of the increase in tax as a consequence of non-provision of tax file numbers. Is there an estimated increase in revenue from that measure?

Mr Ray—The costing of the package incorporates an estimated increase in revenue from that measure.

Senator SHERRY—I think you gave some evidence—not you personally—about that. Can I go to that particular issue. How is that calculated? What is the basis for the assumptions for the calculation? I notice that Mr Gallagher is here with us.

Mr Ray—Yes, Mr Gallagher might provide you with more information on that.

Mr Gallagher—The tax file number estimates were calculated essentially using the same sort of methodology that you have been using, which is looking at what existing coverage rates were, what potential there was for improving coverage rates of tax file numbers and then looking at what the revenue implications might be for the people who may not have tax file numbers at the appropriate date.

Senator SHERRY—The tax office, at estimates I think it was, gave us a figure of 76 per cent of TFNs held by super funds, but the ATO had a further seven per cent, which I think was going to be utilised, bringing the total to 83 per cent. What sort of percentage did you use?

Mr Gallagher—I cannot recall the exact percentage. I would have to take that on notice.

Senator SHERRY—Have you taken into account the fact that there will be a campaign around—

Mr Gallagher—Yes, we thought there would be an active campaign, that we would increase take-up and that the super guarantee funds, where there may be low coverage rates, would be subject to a campaign and that people would be aware of it. Presumably, if they have their TFNs on their member statement, their attention would be drawn to that and people would be able to act. I think they have to act by 1 July 2008.

Senator SHERRY—So there would be an increased percentage of TFNs. Can you recall the figure?

Mr Gallagher—Ms Vivian went through the basic expectations on the numbers, and we are fairly hopeful that would improve. Also, in terms of doing the costing, we have to allow for the fact that there will be refunds.

Senator SHERRY—I was going to get to that issue.

Mr Gallagher—The costing does allow for the fact that, even if they get caught in 2008, there will be refunds in subsequent years.

Senator SHERRY—Did you assume a 100 per cent refund?

Mr Gallagher—I cannot recall exactly, but we normally assume there will be a residual number who do not get their act together. Largely, we anticipated that most of the money we collected would be refunded in subsequent issues and that, therefore, on a true accrual basis, the revenue gain was small but, in terms of cash, it could be appreciable.

Senator SHERRY—What do you mean?

Mr Gallagher—In terms of a cash revenue estimate, the flow may be of significance. It was certainly worth costing.

Senator SHERRY—But you cost everything.

Mr Gallagher—That is true.

Senator SHERRY—You are very good at it. Ms Vivian, maybe you could help us on the increasing take-up of TFNs.

Ms Vivian—I was thinking about the figure you were just quoting. We mentioned that we got about 76 per cent of last year's member contribution statements with tax file numbers, but we now find that, with a tax file number, we can match up to about 93 per cent. That leaves approximately four million active member contribution accounts without a TFN.

Senator SHERRY—You say 93 per cent—that is good—so there is seven per cent. I am a bit puzzled about how the seven per cent translates into four million.

Ms Vivian—Of the member contribution statements that come into us.

Senator SHERRY—I am surprised that the raw number is so high.

Ms Vivian—Sorry, that is four million without a TFN. That translates into about 800,000. About 3.2 million of the four million come in without a tax file number that we can match, which leaves about 800,000.

Senator SHERRY—Thanks. I was really worried by that figure of four million. Looking forward, as you and Mr Gallagher work together, what change are you anticipating in the likely take-up as a consequence of the campaigning and the various changes that will be made? Will it go from 93 per cent up to 95 per cent, 96 per cent, 99 per cent?

Ms Vivian—In the campaign, we will be writing to those 3.2 million people. Assuming that they do not object, our aim is to provide their tax file number directly to the fund. That leaves us with about 800,000 accounts. The interesting thing is that about 50 per cent of those member contribution statements relate to about 12 funds. So our aim is to work closely with those 12 funds to see if we can unpack the data a bit more and get a better match. The other point—

Senator SHERRY—Sorry, just before you go on to the other point: you say that it mainly relates to those 12 funds. Are we dealing here with funds in retail, hospitality—that segment?

Ms Vivian—I would have to check. I think it is mainly some of the large industry funds. Yes, it probably is, but I would need to check that. Of course, of those funds, I do not know how many—these are active accounts, but there would be an element of those accounts, I expect, that would be under $1,000, so therefore the additional tax that would come out would not apply to those.

Senator SHERRY—That is $1,000 contribution as distinct from balance?

Ms Vivian—Yes, the $1,000 is contribution. Of those four million and the number that go through, we have not started doing that level of analysis about whether it will be 95 or 96 per cent, but we will then be starting to unpack, working directly with funds and looking at as many strategies as we can to make sure that we maximise the numbers.

Senator SHERRY—That is fine, and we will come to the campaign detail either here or at estimates et cetera. Mr Gallagher has just mentioned that there is a figure in this revenue head. Surely an estimate was made by either you or him, or by you together, about the percentage that will remain unidentified?

Mr Ray—Yes, and we have taken that on notice, so we will go away and come back to you.

Senator SHERRY—Okay. Mr Gallagher, you referred to the amount of money, the quantum. What was the approximate amount of money that would be coming in and then paid out?

Mr Gallagher—I would need to take that question on notice.

Senator SHERRY—You cannot give us any ballpark figure today?

Mr Gallagher—No. This is a calculation we did some time ago. I cannot recall it correctly, and I think the best thing to do is to take it on notice.

Senator SHERRY—Okay. We will see you at estimates in a couple of weeks and look forward to it.

Senator BERNARDI—Can I just confirm: was your question in relation to the unclaimed super?

Senator SHERRY—No.

Mr Ray—No, the nondisclosure of TFN.

Senator BERNARDI—I beg your pardon.

Senator SHERRY—So we have a calculation in there. I am just interested to see what your assumptions and calculation are. But, Mr Ray, the bottom line is that the money or the considerable proportion of it—you cannot give me the figure today—is money in, money out?

Mr Ray—That is the intention of the policy, yes. It is money in, money out.

Senator SHERRY—There is a three-year claim limit, isn't there?

Mr Thomas—Four years.

Senator SHERRY—Sorry, four years. Is that a special limit for this particular provision or a general limit?

Mr Thomas—That is the general limit that is applicable to tax returns, so that is the standard that has been applied in this case.

Senator SHERRY—We will get back to those specific figures and calculations at estimates in a couple of weeks. There were a number of other suggestions. I am assuming you have read the submissions from ASFA, IFSA, Mercer et cetera about the general difficulties of maximising TFNs and application of the tax penalty et cetera. There have been suggestions from Mercer and IFSA—and ASFA, I think, were sympathetic to those—that this new regime should be deferred for a year because of administrative difficulties, the administrative burden that this presents. Has any consideration been given to that?

Mr Thomas—I think the critical point here is that, with the changes in where the limits in the superannuation system are placed, the significance of the integrity of the caps at the front end is crucial. Obviously, under the changes, the limiters at the back end—the reasonable benefit limit—have been removed. That was the point previously where people were required to quote a TFN in relation to the payment that they were receiving. If they did not quote it at that point then they were subject to the higher TFN withholding. Now that the limit is

effectively at the front end through the contribution caps, both concessional and non-concessional, it is critical that that operate effectively from day one, because otherwise the opportunity is there for people to exceed the limits in that first year, and that clearly would significantly impact the direction of policy.

Senator SHERRY—I understand the rationale for that, but it seems to me that the consequence is that the vast majority of people who will end up paying higher tax as a consequence of non-TFN provision are not people with high contributions attempting to exceed the new contribution limits but will in fact be people with low compulsory contributions.

Mr Thomas—And that is why the government has put in place a $1,000 threshold, to try to protect those people who are getting small contributions. The other thing to bear in mind is that for the vast majority of people who are continuing members of a fund, they will have until 30 June 2008 for that contribution to have a TFN attached to it. So there is a considerable period of time in which people will have, through the various mechanisms that have already been alluded to—the education campaign, the ATO's matching process, the employment declaration form changes that are being implemented—will provide opportunities.

Senator SHERRY—That is the opt out rather than the opt in?

Mr Thomas—Correct, yes, the reversal of the direction of it. All those issues will provide a significant opportunity for people to provide their TFN in all circumstances and not be subject to the higher withholding at the front end, as I have spoken about.

Senator SHERRY—If this is as successful as you claim it will be, I am a little concerned that Mr Gallagher's initial indication that the revenue that is to be collected here is certainly at least worth considering and calculating.

Mr Thomas—There will always be people who will not quote their TFN for privacy reasons or for other reasons. It is going to be an iterative process. The tax office is going to be going backwards and forwards to people and to funds. I would imagine that over the next 18 months it is going to be an iterative process in the accumulation of those TFNs.

Senator SHERRY—Sure, but I have watched this iterative process on lost super accounts for the last 10 years. You know where that is today, don't you?

Mr Thomas—Yes, certainly, but there are issues which the government has indicated it would rest there in terms of definition and that sort of thing, which are basically designed to catch everybody who, in any conceivable situation, could be classed as lost.

Senator SHERRY—Do you know where this iterative process has led to on lost super accounts? Do you know what the figure was in the last financial year?

Mr Thomas—Yes, it is very considerable.

Senator SHERRY—I was going to say extraordinarily considerable compared to the figure of the year before, which was very considerable, which was the answer you gave me the year before, or words close to that, as I recall. The bottom line is that on lost super we are up to close to $10 billion—$9.7 billion.

Mr Thomas—Indeed.

Senator SHERRY—Lost accounts are close to $6 billion. It did not pass my notice that that was an increase of $1.2 billion on the previous year.

Mr Thomas—We certainly expect that with the high penetration of TFNs which will be engendered through this process it will have a significant impact on lost members as well.

Senator SHERRY—I hope so.

Mr Thomas—As well as the other changes the government is making.

Senator SHERRY—I have questioned—not you—all the time and you will certainly recall me asking about the rise in lost super over the last 10 years. Each year I am referred to a new iterative process, a new education campaign. I can recall three of them and the figure keeps going up, does it not, Mr Thomas?

Mr Thomas—You are on the record as saying that, yes, Senator.

Senator SHERRY—I am on the record as asking you and the evidence is there.

Mr Thomas—You look at the figures.

Senator SHERRY—Yes, and the figures speak for themselves. Every year you have pointed me to another campaign. I am not blaming you individually or the tax office. I know it is a very difficult job for the reasons which were well outlined in the Mercers submission, for example. You accept that there is a problem of inertia and collection of things like addresses and TFN numbers in this area.

Mr Thomas—Certainly. The incentives were not there in the old system because it was not until the point where the benefit came to be paid that the TFN had to be quoted. So, where the TFN is the identifier of certainty in the system, then that in itself, because of when it is critically required to be made, leads to those problems much more and they will be addressed through the earlier collection of TFNs under this regime.

Senator BERNARDI—Senator Sherry, may I put a question on notice?

Senator SHERRY—I've just got one area I want to finish.

Senator BERNARDI—Sure.

Senator SHERRY—Mr Thomas, I want to come back to a point you made earlier, about the $1,000 exemption—that is, in contributions annually. Let's take SG, which is nine per cent. That is an income of $9,000; that is a really low income.

Mr Thomas—Yes.

Senator SHERRY—Did you give any consideration to a threshold higher than $1,000? It would seem to me that, if you want to remove the bulk of people who would be impacted by this higher tax treatment through the nonprovision of a TFN, a figure of, say, $10,000 in contributions per year might be more appropriate. You would still then include, really, what I am sure is the greatest concern—high-income earners using some sort of avoidance mechanism.

Mr Thomas—Certainly, those sorts of representations were made to the government during the consultation process, that the threshold should be higher, and figures of $3,000,

$5,000 and $10,000 were put to the government. The government took the view that the $1,000 figure essentially struck a balance between the need to protect people who have very small contributions made and therefore may not be in touch with their superannuation fund or the contributions that are being made on their behalf, and the possibility that exists for people to spread contributions across a number of funds in order to not have the penalty for withholding applied to those contributions. For example, if you took a $10,000 figure, it would be relatively easy for someone who was getting superannuation contributions of $60,000, or salary-sacrificing to provide for deductible contributions of $60,000, to spread that across seven superannuation funds and therefore get in under the limit.

Senator SHERRY—Where it is an extra voluntary contribution, I would accept that. What about compulsory SG contribution? It seems to me it would be difficult for an individual to spread the compulsory contribution to multiple funds, from one employer.

Mr Boneham—I think there is an issue there about the funds identifying what is compulsory and what is voluntary. If you look at the APRA stats, they do not do that.

Senator SHERRY—I know they don't.

Mr Boneham—So I am not quite sure whether or not funds are geared up to actually do that.

Senator SHERRY—You see, again the group that is most likely to be affected by this is the group that I would suspect is not making salary-sacrifice contributions anyway—if you are on a low to middle income with SG of nine per cent. Anyway, we will obviously explore the details of the campaign and its success, or the take-up rate. I am sure you will get a higher number of TFNs, but the bottom line is that getting 99 per cent would still leave 100,000 people, the considerable majority of whom will not be people trying to avoid the caps.

Mr Thomas—And certainly it is not the government's intention to try to collect revenue from this measure.

Senator SHERRY—But the government is collecting revenue.

Mr Thomas—Yes, but that is not the purpose of the measure. The purpose of the measure is to ensure that the contribution caps are effective and that they provide the limiters that are necessary in the system.

Senator SHERRY—I understand that, but the fact is that, whatever the number of people who try to avoid the caps may be—1,000 or 10,000—it will be people who for whatever reason are not in that category.

Mr Thomas—Certainly a balance has to be struck somewhere, yes. And that is a policy decision of the government.

Senator SHERRY—Yes, and I accept that. I accept it is policy decision. But I am trying to get to the revenue that is included in these figures—and there are other issues about the campaign. I just do not want to be here—well, hopefully, I will not be on this side of the table next year, but, if I am, I might have to defend the implementation of this policy, sitting next to you, Mr Thomas, in estimates! I am sure my wise words and questions will be quoted back to me and I will have to justify this approach! But, seriously, my overriding concern is for those

who are legitimately on a low to middle income who will be paying significantly higher tax, through no fault of their own, in a compulsory system. I will leave it there.

Senator BERNARDI—I have a couple of questions that relate to the line of questioning from Senator Sherry. What happens to the funds that are remitted to the states for lost super? Do they remain invested or are they put into a bank account?

Mr Boneham—Our understanding is that they are retained in consolidated revenue of the states.

Senator BERNARDI—Therefore, there would be no difference effectively if the funds were to be retained within a Commonwealth authority.

Mr Boneham—They would also form part of the Commonwealth's consolidate revenue. From what the government has stated, people are better off having a one-stop shop for those unclaimed moneys than having to go through each state trying to find their unclaimed money. I think the government has stated that as its overriding objective in moving those moneys to the Commonwealth.

Senator BERNARDI—The funds are allocated to each state currently according to the last known residency of the person.

Mr Boneham—Where the fund is established. It is possible for someone who worked all their life in Queensland to have their money sent to New South Wales.

Senator BERNARDI—So I would not be drawing a long bow by saying that New South Wales and perhaps Victoria, being the centre of the funds management industry, would retain the bulk of the funds.

Mr Boneham—The majority is probably going to New South Wales, but I do not have those figures.

Senator BERNARDI—I do not really need them; I was just interested in that. Senator Sherry has indicated that the number of accounts has grown quite significantly and I think they are across 12 superannuation funds.

Ms Vivian—The number I was talking about related to members' contributions statements, so they were about what I would call active accounts. The numbers that Senator Sherry was talking about are the lost members. Effectively, in most cases, they are accounts where either people have stopped contributing money or the funds can no longer contact the person. They were different figures.

Senator BERNARDI—Those funds are protected where the contribution is under $1,000 per year. Is that right?

Ms Vivian—That is true. However, here I think some of the funds roll them over into what they call an ERF in order to protect them from administrative costs, but they still get reported on the lost members' register.

Senator BERNARDI—We are talking about a sum of $1,000. It is a relatively low income. As Senator Sherry said, typically these people are involved in the retail industry and the hospitality industry, where there is a lot of part-time work. It was interesting to note that

the majority of these people will not be disadvantaged because of any penalty tax regime. Is my understanding correct?

Mr Thomas—That is certainly correct, yes.

Senator BERNARDI—That being the case, it narrows the field of those who will face penalties, given today's evidence that many people in some industry funds are in part-time work. I just wanted to clarify that.

Just briefly on another topic, I am interested in a comment made earlier in a submission by the CPA that the residency test may have been a legislative oversight, having been changed for that reason. Do you have a comment on that and on whether it is intended to change it again?

Mr Thomas—Yes. The wording in the bill is different from what was in the 1936 act. A broad sweep of provisions was moved into the 1997 act as part of the redrafting of the legislation. That was done to improve and simplify the language and to bring all the superannuation provisions together into a number of discrete parts of the tax act, which people could more readily follow. The changes in the wording of the residency test were for simplification. That was the intention with the way the provisions were being drafted. It was also intended to improve the tax office's flexibility in deciding if somebody fits into the category of being—I forget the terminology now—

Senator BERNARDI—Ordinarily resident.

Mr Thomas—ordinarily resident in Australia. But certainly there was no intention to significantly narrow the application. If anything, it was intended to supply some flexibility to the tax office to say that someone who did not meet the strict tests under the old law, which were very prescriptive and were spelt out in numerous sections of the law, might still fit within the 'ordinarily resident' definition, which is now contained in the draft bill.

Senator BERNARDI—Do you understand that accountants particularly do not like ambiguous language in these sorts of areas. The previous one was very prescriptive with 28 days in two years, I think—I am just paraphrasing it—whereas now it is deemed to be 'ordinarily out of Australia'. It is a subjective test that the tax office can apply.

Mr Thomas—We do have the protection that, where the changes are purely for the purposes of wording, it does not impact on the interpretation of those provisions. That is in the Acts Interpretation Act and that is certainly there as a fallback. I am happy for Ms Vivian to elaborate, if she wants to, but I would certainly expect the tax office to provide further guidance on that area.

Senator BERNARDI—I would be interested in your comments in this regard, Ms Vivian. However, I do not think it is ever the intention of any government to force difficulty upon people interacting with government agencies. I want to make sure that is not the case either by intent or description. Do you have a comment to make on that?

Ms Vivian—Not a great comment, but we will certainly be working with the industry—we have a few reference groups that we work through—to make sure that we put some guidance out there so that people are not dealing with a lack of interpretation or confusion. That would be simply our starting point.

Mr Thomas—I would make the further comment that these issues have been raised with us quite recently, following the bill being introduced into the House of Representatives, so it is something that the government has taken on notice and will look at.

Senator BERNARDI—Which is why I raise it. It was indicated to us that perhaps it was considered an oversight, which was the terminology used. I am sure you heard that testimony and you were prepared for it.

Mr Thomas—Yes.

Mr Forsyth—The fact that it was covered in the end would indicate that it was not an oversight, I would suggest.

Mr Thomas—It was intended to be a simplification of the provisions.

Senator BERNARDI—Thank you for that clarification.

Senator WEBBER—I have a couple of questions following on from the evidence we got from the Regular Defence Force Welfare Association. Coming from Western Australia, I must admit that I was particularly moved by the evidence given to us by Mr Wade. They seem to be of the view that some members of their funds under this new regime will be forced to pay more tax and not less. Is that a correct interpretation?

Mr Thomas—It would be very surprising if they were paying more tax instead of less under the regime. From the arrangements that have been put in place with the removal of end benefits tax on tax schemes and the equivalent arrangements for untaxed schemes or where there is an untaxed element—it might be a hybrid scheme with a combination of member contributions and an unfunded employer contribution—members of those schemes also receive a benefit. If they are receiving a lump sum, the tax is reduced by 15 percentage points. If they are receiving a pension, they receive the 10 per cent tax offset. That applies irrespective of when the pension commences; it does not have to commence from the commencement of the simplified superannuation regime on 1 July. It also applies to all existing pensions. So certainly members of those schemes would be eligible for that 10 per cent tax offset and that should lead to a reduction in their tax. Of course, the age criteria is there, which I had taken as given. But, just to reinforce that, that applies to people who are over the age of 60.

Senator WEBBER—Has there been any formal consultation between Treasury or the ATO and organisations like the Defence Welfare Association?

Mr Thomas—The government has certainly received submissions from those organisations. Members of those organisations have written to government ministers about these issues. I do not think Treasury has met specifically with the Regular Defence Force Association. We have met with peak bodies representing retired government employees.

Senator WEBBER—Defence personnel do seem to me—and I do not have anywhere the knowledge of these issues that my good friend Senator Sherry does—to be a special category of people. They are not like any of you, for instance, in that we do not go out of our way to put you in harm's way, and you do not have to deal with the physical issues. There is not the compulsory age retirement; there are none of those issues. Estimates with Senator Sherry may get a little rigorous, but I doubt they physically harm you, although that may be a new thing if

we do not get answers to questions on notice! They do seem to have some special issues. We just thought, by consulting with general ComSuper people, that they were covered.

Mr Thomas—We would be happy to talk to anybody who came to us and indicated they wish to talk to us about issues. Principally, with government employees of one form or another, that was done through the peak industry bodies. I think that quite a number of the issues that were raised in the submissions to you on this issue really relate to the design of the particular schemes that were referred to.

Senator WEBBER—Designed by government.

Mr Thomas—Certainly, yes, over a period of time. Many of them have been in place for a long period of time.

Senator WEBBER—Absolutely.

Mr Thomas—The focus of the government's attention in this particular package is a broad one, looking at the way the system as a whole operates. The government had particular regard to the different circumstances of taxed schemes versus untaxed schemes and looked at the particular arrangements that were necessary in each of those broad groups. But, in terms of the design of particular schemes, that is something which has not clearly been within the purview of this package of arrangements that the government is heading into.

Senator SHERRY—How did you get the figure of 10 per cent? There are different schemes with different levels of contribution. Effective levels of contribution in a defined benefit are quite different.

Mr Thomas—It is a rough approximation of the numbers of people in schemes. Where there is an unfunded employer contribution—that is, basically Commonwealth and state schemes where the government contribution does not occur on an ongoing basis—

Senator SHERRY—I am talking about the 10 per cent rebate, not the estimate of the number of people in a defined benefit. Where did that 10 per cent figure come from?

Mr Boneham—The 10 per cent is to provide a proxy effective tax rate of 15 per cent on pensions. If you look at the tax rate applying to lump sums as a straight 15 per cent, you see that because pensions are included in assessable income you need to consider the amount of tax they would have paid on that as treated as income. Then, a 10 per cent rate gave us a fairly close approximation for the majority of untaxed members at around 15 per cent for the people, so as to make sure that the majority of untaxed people do not pay more than 15 per cent.

Senator SHERRY—So, in terms of the methodology and outcome, it is an average?

Mr Boneham—No, it is not really an average. It is an approximation to make sure that the majority of untaxed pensioners do not pay more than an effective tax rate of 15 per cent.

Senator SHERRY—Sure, but if you drill down into individual schemes and individual members—

Mr Boneham—The 10 per cent rate does not really depend on fund design. It depends on the actual amount of pension received from the fund.

Senator SHERRY—So in all cases would it be an accurate reflection of the benefit that they receive from the fund? I do not see how it can be a figure of 10 per cent.

Mr Boneham—I am not quite sure what you are getting at, Senator. It really depends on the amount of pension paid from the fund. It does not really depend on how that fund determines that benefit.

Senator SHERRY—Yes, but the impact is on the individual.

Mr Boneham—That is right. The impact on a person who receives $40,000 from the PSS or $40,000 from a Defence Force scheme will be exactly the same.

Senator SHERRY—But in the case of Defence Force personnel who are invalided, one of the arguments is—and I think it does have some validity—that if you are permanently invalided, category A for example, there is a high chance that, if you were in your 30s, you would not have reached your optimum income for the purposes of payout from that pension fund because your income would have gone up over time. I think that is a reasonable assumption. But with this approach, you are not able to take into account that difficulty for a person who is incapacitated.

Mr Boneham—That really is an issue for fund design. I understand that the PSS, if, let's say, I am made permanently disabled today, will project out my future income until I am aged 60 and they will base it on that income. Some funds may actually provide you with an estimate based on that.

Senator SHERRY—My question went to the circumstances of a person in the military who was invalided as a result of their service.

Mr Boneham—I am not aware of the design of the military schemes.

Mr Thomas—That is an issue for the military. It is essentially the responsibility of the Minister for Veterans' Affairs.

Mr Ray—There is nothing in this package which changes the tax treatment from the date of invalidity to the age of 60. Then there is the benefit post 60 for that example.

Senator SHERRY—I understand that, but part of their argument is that it should be tax free given that circumstance and other circumstances.

Mr Thomas—That then raises issues of equity and precedent as well across the board.

Senator SHERRY—Yes, but you would get issues of equity about why the benefits in the DB in terms of the employer contribution are higher than the general public sector. There is a recognition of the type of work and the dangers et cetera of serving for your country and in this case being incapacitated. But it is not reflected in the tax treatment.

Mr Ray—That is what Mr Boneham and Mr Thomas have said. An alternative way of thinking about it rather than thinking about the tax treatment is to think about the scheme design for these particular circumstances for defence personnel.

Mr Thomas—That is a policy decision for government in their role as employer rather than as anything else.

Senator SHERRY—I accept that. Either of them is a policy decision: the design of the scheme is a policy decision of government as indeed the 10 per cent tax treatment to these people is a policy decision.

Senator WEBBER—But, from the point of the person in Western Australia who was made a paraplegic after the Blackhawk helicopter crash, it is not a pleasant policy decision to have this happen to him. He is permanently incapacitated and he is going to be on an indexed pension of about $35,000 for the rest of his life.

Mr Thomas—I appreciate that.

Senator WEBBER—He is finding it a little confronting. Was any consideration given to exempting these funds, particularly the category A pensions?

Mr Thomas—As I said, the government looked at the treatment for untaxed schemes as a whole and taxed schemes as a whole and that was the level at which the decisions were taken.

Senator WEBBER—Thank you.

Senator SHERRY—I have a question on the issue of foreign schemes and their treatment. For example, I have had representations from persons who formerly worked in the UK, now resident in Australia, wanting to transfer all their money, and there is the contribution cap. That is one example—it is a pretty frequent example. The other is former UN employees. Are those types of issues still under consideration? I appreciate they are complex and require fairly detailed examination of country of origin and the nature of the funds. Is there more work being done in this area?

Mr Thomas—In looking at the exemptions to the caps, the government consulted very widely on that issue. The evidence that it got and helped form its decision on this issue was that the vast majority of overseas transfers could be accommodated within both the $1 million transitional cap up until 30 June this year and then the ongoing $450,000 index non-concessional cap in out years. The evidence that came to government was that the vast majority of transfers could be accommodated within those limits. It was put to government that—

Senator SHERRY—Sorry; within those limits while those limits remain.

Mr Thomas—Those limits are ongoing in that every three years there is a $450,000 non-concessional contribution limit. If people are able to transfer moneys in part, that can be accommodated within that.

Senator SHERRY—That is a big if, isn't it?

Mr Thomas—It is. In some jurisdictions they are able to; in others they may not be able to. In the lead-up to 30 June there is the $1 million transitional cap. There was a lot of concern about the potential for abuse in putting in special arrangements for overseas transfers,. We have had experience in the past with, for example, the controlling interest arrangements some years ago—you may recall those—where people were making contributions to overseas superannuation funds to avoid limits in Australia. It was moving through overseas funds and then back into Australia. The government had to introduce changes to limit that. To put a regime in place which had regard to particular circumstances of all the jurisdictions would

have been a very complex exercise, and the government took the view it could not be justified given the evidence.

Senator SHERRY—I accept that; however, the UK and the US have large existing private pension systems—I do not have the immigration stats but I am sure they are higher from those jurisdictions—and the nature of those pension systems is very different compared to, say, western Europe, where there is a very small private pension and they are mainly state run systems. That is in the main, but it is not the case in every country. There is a larger issue emanating from those two jurisdictions than from any other country for those reasons. At the end of day, I accept your concern about tax evasion and contrived arrangements. Surely, it would be better if the moneys are in our jurisdiction rather than, say, in the UK jurisdiction or spread across two jurisdictions in the case of a bona fide person with a private pension from the UK.

Mr Boneham—I think there is an issue about what would be a bona fide pension. I know they have some well-established employer schemes but they also have a pretty strong fund management sector. Would a bona fide scheme also include an amount of money just transferred into a UK public offer fund, for example, and then transferred back into Australia? So then you are looking at setting rules about what is bona fide.

Senator SHERRY—In the case of bona fide employer-sponsored superannuation trusts—corporate funds as we know them—there are millions of people in the UK in those arrangements at the moment.

Mr Boneham—You also need to consider if it is a bona fide arrangement or just a personal arrangement in an AMP type scenario.

Senator SHERRY—I understand that. I hope you are not implying AMP is not a bona fide arrangement—be careful!

Mr Boneham—Certainly not.

Senator SHERRY—In terms of the personal SIPs type product in the UK, there are millions of people in those arrangements. I accept that, but there are also millions of people—many more than here—in bona fide corporate arrangements to foreign benefit funds.

Mr Boneham—I am not sure if this is one that you can easily ring fence. Why should someone who works in the UK have a better opportunity to move funds than someone who has a similar arrangement in France or Germany?

Senator SHERRY—Because they do not have them in France.

Mr Boneham—I understand—Switzerland then.

Senator SHERRY—That is the gut of the issue: why this is predominantly a UK/US issue.

Mr Boneham—But Switzerland also has a very well-established funds management scheme outside the corporate sector—Chile as well.

Senator SHERRY—But I do not run into too many Swiss or Chilean people in the street.

Mr Boneham—It only takes one.

Senator SHERRY—But there seem to be a significant number of people from the UK in this category.

Mr Boneham—But why should people be discriminated against because they worked in Switzerland as opposed to England?

Senator SHERRY—But why should they have to have moneys in two jurisdictions, for example? They can transfer some but they cannot transfer others.

Mr Boneham—The issue then is the one that Mr Thomas raised, which is that it is an integrity risk.

Mr Thomas—And whether it is justified, given the evidence that came to us about the vast majority being able to be accommodated within the limits. Is it a complexity that is necessary in those circumstances?

Senator WEBBER—In states like mine, Western Australia, it is an increasing issue.

Mr Thomas—Certainly we have had representations from WA.

Senator WEBBER—It is not going to go away, so we need to start thinking about it.

Senator BERNARDI—Is it fair to say that the intention of the proposed legislation is to ensure that the majority of people are not disadvantaged and can comply with the law, also balanced against the need to reduce or stop any opportunity to rort the system?

Mr Thomas—Certainly that is a very important consideration.

Senator BERNARDI—I think that comes to the nub of the issue.

ACTING CHAIR—Thank you very much for your attendance this afternoon. It was a very quiet contribution from some members, but that is okay. This concludes the hearing on the inquiry into the Tax Laws Amendment (Simplified Superannuation) Bill 2006 and the five related bills. I thank you for your evidence. You have taken some questions on notice. Senator Sherry has asked if you can provide those answers at estimates or beforehand as that would be helpful.

Committee adjourned at 4.47 pm