



**DRAFT**

## **Housing Advance Scheme – Proposal to revamp the scheme to avoid cumbersome taxation issues**

### **Purpose**

The purpose of this paper is to seek endorsement from the ASFPNG on a fundamental change to the housing advance scheme to remove cumbersome taxation issues relating to the treatment for housing advance under section 29(1)(r) of the Income Tax Act

Once there is broad agreement on this paper we will submit to the Superannuation Taskforce for their deliberation and actioning.

### **Background**

On the 5<sup>th</sup> of December 2005, the Superannuation Taskforce met with industry representatives, Central Bank and the Internal Revenue Commission (IRC) to discuss a number of issues including taxation on housing advances.

### **Current Position**

Under section 29(1)(r) of the Income Tax Act, a housing advance must be applied as follows

1. The withdrawal must be to facilitate the purchase of a **first** home
2. The withdrawal must be a repayable amount
3. The house purchase must be no greater than **K75,000**
4. The contributor may access amounts owed in respect of recreation leave, furlough, (long service leave), gratuity or **superannuation entitlements**.
5. The amount cannot be paid directly to the employee/contributor
6. Evidence must be shown that the withdrawal is for the purpose of purchasing a **first** home.

*Source: David Sode, Taxation Commissioner IRC Post Courier 01 –12-2005*

### **Implications**

Currently most, if all not all ASF's have failed to meet the strict criteria as stated above albeit inadvertently. A rough assessment would be that ASF's have failed to adequately meet criteria 1, 2, 3, & 6

The important point is that from a taxation perspective, a contributor faces the following fairly complex taxation arrangements when seeking a housing advance

1. The employee portion of an advance would not be taxable – (60% of the employee portion)
2. The employer and interest portion (60% of the employer and interest portion) would be subject to taxation if
  - The housing advance was to be applied for a house over K75,000
  - The housing advance was for a second home, i.e. not a first home buyer
  - The advance was not fully repaid by the 2% repayment currently imposed S90 (4)(c) before retirement or unemployment.
  - The advance was for maintenance, extensions to an existing home or whitegoods and electrical permitted under the current recognised draft prudential standard on housing recognised by the ASFPNG

The problem for ASF's in the now quite clear taxation rules relating to housing include the following

1. trying to explain these rules to respective memberships that on the surface seem rather complex
2. ensuring systems both computer and people driven now meet the taxation rules as spelt out in page 1
3. ensuring that we maintain as a sensible policy outcome of consistency in the rules between ASF's relating to housing advances
4. attempting to ensure transferees from one ASF to another ASF are treated correctly where data capture on the transfer may impinge on proper taxation collection.

### **Review of Housing Advances under Superannuation in the absence of deletion of superannuation entitlements under section 29**

It would be fair to conclude that section 29(1)(r) that was set up many years ago to encourage home ownership will not be abolished. Similarly discussions with taxation officials suggested that the only change that would be considered is a higher housing price limit from the current K75,000.

One way of dealing with section 29(1)(r) of the Income Tax Act is to seek the removal of all references to superannuation within the Act. In this way we can continue on as done currently. How long it would take for a change to the Income Tax Act in this regard is anyone's guess. However if we support this move, then we could be facing non-compliance or a severely limited housing advance program for a number of years to come. Similarly we remain unsure as to whether the IRC have even any remote interest in changing the Act as it now stands.

Clearly however to support the status quo will cause added complexity to the superannuation system.

To remove the taxation problems associated with the above and on the proviso that we cannot change the Income Tax Act within a reasonable time frame, it is recommended

that Section 90 (4) in relation to housing be reviewed with the following sections changed

Paragraph (b) be altered from *the withdrawal does not exceed 60% of the members entitlement*

to

*(b) the withdrawal does not exceed 100% of the employee portion of the members entitlements*

and

Paragraph c) *the member shall increase the rate of contribution to his ASF by a further 2% until further contributions reach an amount such that the accumulated funds are restored to the level that would have applied in the absence of the withdrawal.*

To

*c) In order for a member to obtain a further advance, the member shall increase the rate of contribution to the ASF by a further **minimum**~ 2% until further contributions reach an amount such that the accumulated funds are **restored to the amount of the last advance taken**#.*

#### Note

~ Please see NASFUND submission page 21 which concluded that the average person would not be able to repay an advance over their working life base on a 2% added contribution rate.

# In relation to the “restored to the amount of the last advance taken” it is recommended that this be the preferred wording. The current wording is ambiguous in that the statement “ the level that would have applied in the absence of the withdrawal” suggests the real value included forgone earnings by taking the advance.

#### **Implications of the change**

1. The Member shall have the option to have further housing advances if he contributes the further 2% minimum
2. by allowing members to increase their rate above 2% then Members will have the possibility of actually repaying their advance which is only theoretically possible currently.
3. If the member voluntarily does not increase the rate of contribution then the member can not have a further advance
4. The employee portion being a 100% means that the advance is tax free
5. The proposal is easily explainable to the membership
6. The proposal means minimum system changes for existing ASF's
7. The proposal leaves a greater amount in the superannuation system for what is essentially retirement.

8. The system should have ready appeal to those Funds's with unfunded employer portions meaning consistency with fully funded ASF's.
9. Certain members who are currently salary sacrificing through employer sponsored packaging (up to 15% employer contribution) would be disadvantaged from the proposal as their employer packaged amounts could not be used for housing.

**Recommendation:**

That the ASFPNG adopt as policy

1. A change to section 29(1)(r) to the Income Tax Act with removal of all references to superannuation (if it can be done within a reasonable time frame) and leave the 60% employer and employee contributions accessible for housing as is  
or
2. a move to 100% employee contributions only as the basis for a housing advance and effectively prohibit taxable superannuation components from being included in such an advance, thus ensuring compliance with the Income Tax act as it stands.

**Proposer: Rod Mitchell**

**06 December 2006.**