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27 February 2009

AFTS Secretariat
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Dear Sir

Australia's Future Tax System (AFTS)
Retirement Income Consultation Paper

The Taxation Institute of Australia ('Taxation Institute') is pleased to provide the attached submission prepared by our Superannuation Subcommittee in response to the AFTS Retirement Income Consultation Paper ('Retirement Paper').

We strongly support the Government's decision to bring forward its consideration of the retirement income system to enable a more appropriate response to the issues facing this system in the context of the broader AFTS Review.

Whilst we appreciate that the scope of the Retirement Paper is to stimulate community input into the AFTS Review Panel's consideration of a broad range of issues relating to retirement income, our comments are focused specifically on issues raised in section 3 of the Retirement Paper, *An acceptable retirement income system*. Section 3 looks at compulsory saving and support for the retirement income system through taxation and other concessions.

As it is our understanding that the Retirement Paper is to facilitate public consultation, the Taxation Institute is happy to meet with the AFTS Review Panel to discuss our submission in the context of the Retirement Paper.

If you would like to meet with the representatives from the Taxation Institute or require any further information or assistance in respect of our submission, please contact Joan Roberts on 03 9611 0178 or the Taxation Institute's Senior Tax Counsel, Dr Michael Dirkis on 02 8223 0011.

Yours faithfully

Joan Roberts

Joan Roberts
President

Submission by the Taxation Institute of Australia in response to the Australia's Future Tax System Retirement Income Consultation Paper

February 2009

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1. Introduction

1.1 Scope and structure of our submission

The Taxation Institute of Australia ('Taxation Institute') is pleased to provide its submission in response to the AFTS Retirement Income Consultation Paper ('Retirement Paper').

We strongly support the Government's decision to bring forward its consideration of the retirement income system to enable a more appropriate response to the issues facing this system in the context of the broader AFTS Review.

The Taxation Institute believes that Australia's three pillar retirement income system – a government provided Age Pension, compulsory savings enforced through superannuation guarantee ('SG') and voluntary savings (both through superannuation and other sources) – is an appropriate structure for providing retirement security for Australians into the future.

Whilst the Retirement Paper contains a series of questions intended to assist in the preparation of submissions and we appreciate that the scope of the Paper is to stimulate community input across a broad range of issues relating to retirement income, our comments are focused specifically on the issues raised in section 3 of the Retirement Paper, *An acceptable retirement income system*. Section 3 looks at compulsory savings and support for the retirement income system through taxation and other concessions.

Our submission in this regard is not intended to provide an exhaustive list of all the taxation related issues, but rather focuses on the following range of key issues, discussed below, that we believe need to be considered as part of the retirement income review:

- retention of tax and other retirement related concessions
- level of Superannuation Guarantee
- greater incentive for lower income earners to save in superannuation
- deductibility of superannuation contributions
- tax free benefits on and after age 60
- elevation of caps
- preservation and non-concessionals
- co-contribution

1.2 Preparation

Our submission has been prepared by the Taxation Institute's Superannuation Committee, whose brief encompasses the operation of the superannuation legislation and regulations in the context of Australia's retirement income system.

Members of our Superannuation Subcommittee are respected experts and leaders in their field with extensive experience in advising on all facets of superannuation both in the public and private sectors.

A number of our Subcommittee members also currently or have in the past represented the Taxation Institute in consultations with the Australian Taxation Office and the Treasury on a broad range of superannuation issues both at the administrative and policy levels.

The current membership of our Superannuation Subcommittee is appended to the submission.

2. Retention of tax and other retirement related concessions

At times, there has been criticism from certain sections of the community in respect of the assistance given to the superannuation system through the tax concessions provided. This criticism has been fuelled by the regular release by Treasury of estimates of the annual cost of providing these tax concessions. Many, however, believe that the estimates calculated by Treasury are overstated.

There is widespread support for a superannuation system under which the Federal Government offers assistance to individuals who wish to provide for their retirement through superannuation. Many in the community see the assistance offered as a prerequisite to saving through the superannuation system, due the inaccessibility of the savings for long periods of time through the preservation rules.

Prior to the current economic climate, the tax concessions afforded to the superannuation system had not unduly impacted the budgetary position of the Federal Government. Whilst there may be arguments for and against specific aspects of the tax concessions provided to the superannuation system, we believe that the current level of concessions is not unreasonable and needs to be maintained into the future. This is a case of short term pain for long term gain because it will ensure more people make provision for their retirement rather than relying completely on future government funded retirement (as noted in 4 below).

3. Level of compulsory saving

In respect of the level of SG, the Retirement Paper notes that

> [a] frequent message in submissions is the need to increase compulsory savings with targets being 12 or 15 per cent of remuneration common. The proposals include increasing the SG or requiring higher employee contributions. This is seen as particularly important for individuals with broken work patterns to increase their retirement income.

As indicated above, the Taxation Institute believes that compulsory savings enforced through SG, along with a government provided Age Pension and voluntary savings, provide an appropriate three pillar structure for ensuring retirement income security for Australians both now and in the future.

Whilst the SG is an integral part of this three pillar retirement income system, the Taxation Institute is concerned to ensure the level of compulsory saving does not have an unnecessary adverse impact on pre-retirement standards of living. In particular, the adequacy projections suggest a person working 35 years will have a reasonable saving but the difficulties arise for those with shorter or broken working lives. Simply raising the SG rate overall does not fix these problems, which should perhaps be dealt with through other methods including the social security system and further encouragement of voluntary savings. The Taxation Institute considers it important to maintain the equilibrium of the three pillars.

4. Greater incentive for lower income earners to save in superannuation

Whilst clearly a significant generalisation, there are broadly three groups of retirees:

- a group that will never have earned enough during their working lives to have made any significant retirement savings;

- a group that is already motivated by existing concessions to save; and

- a group that is not currently motivated by existing concessions to save but may be encouraged to do so if additional or alternative concession options are available.

Whilst the Taxation Institute believes that policy development needs to encourage all three groups to save through superannuation, we recommend at this stage that the review focus in particular on the third group listed above (‘Target Group’), without removing the incentive for the second group to continue their valuable saving activity. This policy development could focus on three main areas:

- means testing;

- tax incentives; and

- non-tax incentives.

Means testing

Any form of means test in relation to an age pension presents a problem for those individuals who have the potential to exceed the income and asset levels over which the government funded pension is reduced.

Every additional dollar they save has the potential to reduce their government funded benefits without necessarily making the individual any better off in retirement. This issue is most relevant for the Target Group.

Given the fact that government funded benefits will be lost as a result of additional savings by the Target Group, the financial and other incentives required in order to lift their savings rate must be very significant.

The fact that the Target Group are relatively poor savers is a possible indication that the current incentives are insufficient to redress this problem.

Commentary on superannuation policy too often focuses on the cost to revenue of providing superannuation tax concessions, but there are clearly even more significant longer term and enduring revenue benefits to be had from encouraging more Australians to fund their own retirement and relying less on government provided benefits. These revenue benefits must also be included in any analysis of this issue.

Tax incentives

Currently a contribution tax is levied on concessional contributions at 15%. The Taxation Institute is concerned that this rate of tax is too high in relation to the Target Group, particularly if most individuals within this Group pay a 30% rate or less on their personal incomes. The 15% (or less) tax differential between personal income and a concessional superannuation contribution is an insufficient incentive to make up for the fact that the additional saving will reduce the Target Group’s government provided benefits and be locked away in superannuation until preservation age.

We believe that policy measures are required in order to increase the tax incentive for the Target Group. We suggest that consideration be given to:

- providing a form of taxation rebate that might be offered to employees where their total taxable income for a financial year attracts a personal marginal rate of taxation of less than 15%. Currently that would apply to any person earning less than $34,000 per annum. This type of rebate would remove the disincentive currently faced by these employees to receive remuneration by way of additional employer contributions. It may be particularly important if consideration is being given to the introduction of soft compulsion or increasing the superannuation guarantee rate; and

- increasing the current level of co-contributions.

Other incentives

Tax concessions are not the only way to encourage the Target Group to make additional savings. In order to encourage personal retirement saving, we believe the preservation age for voluntary superannuation contributions (ie, non-concessional contributions and contributions in excess of SG) must be set at an age significantly less than the age pension age.

In our view, any move to align preservation age with the age pension age will have a negative impact on all voluntary superannuation savings. We also suggest that:

- in order to prevent abuse of this differential that any benefits taken before age pension age must be taken in the form of a non-commutable income stream (eg, a term allocated pension), noting that any disincentive to this as a result of the application of bankruptcy laws will need also to be addressed; and

- the link between retirement from the work force and the ability to access superannuation at preservation age be removed entirely in relation to any non-commutable income stream. This principle has already been established in relation to transition to retirement pensions but does not apply to term allocated pensions.

The above measures will:

- encourage additional savings (because they will be accessible before retirement age);

- not result in any “double dipping” because the additional income stream is non-commutable; and

- not result in any additional losses to the workforce, as there is no link between retirement and the ability to access non-commutable income streams once preservation age has been reached

5. Deductibility of superannuation contributions

The Taxation Institute recommends a review of the deductibility rules for personal superannuation contributions, notably the requirement at section 290-160 *Income Tax Assessment Act 1997* (‘ITAA 1997’) that earnings as an employee must be less than 10% of the total assessable income plus reportable fringe benefits (the “10% rule”).

This rule originated when the constraints on annual deductions did not involve a single personal cap. In particular, the 10% rule was intended to inhibit the use by each single individual of two deduction limits. With the introduction of universal annual limits that apply on a person by person basis, we maintain that the 10% rule is no longer necessary and adds a needless complication to the deduction rules.

If the 10% rule were abolished, individuals would be able to deduct personal contributions, subject to the remaining conditions set out at sections 290-155 to 290-170 ITAA 1997, and subject to the individual concessional contribution cap. As currently, notice of intention to claim a contribution would be provided to the complying fund's trustee and the amount under the notice would be aggregated by the ATO with other concessional contributions. No double dipping would result.

Additional benefits would arise.

For instance, equity concerns have been expressed that salary sacrifice arrangements are not universally accessible. Salary sacrifice arrangement rules are also subject to complex rules about "prospective" sacrifice and concerns about when an amount of earnings has already been derived. If individual deductions were not subject to the 10% rule, the individuals concerned would no longer need to enter into complex contractual arrangements with their employers to ensure deductibility of amounts in excess of superannuation guarantee ('SG') minimum or other mandated amounts. They could seek a deduction for the additional amount through their personal income tax returns, and this would remove significant administrative complexity. Further, this arrangement would remove much of the complexity of the proposed arrangements for reporting employer superannuation support in excess of the SG minimum set forward in the Treasury Consultation Paper *Reforms to Income Tests*, and issued for public comment in November 2008. On the basis of removing complexity alone abolition of the 10% rule is imperative.

6. Tax free benefits on and after age 60

The recent Simplified Super changes removed the taxes on most superannuation benefits received by individuals on and after their 60th birthday. The Taxation Institute supports the general thrust of most superannuation benefits being tax free after a certain age. The change has had a positive impact on the community's perception of the superannuation system and, over time, will result in significant simplification of the system and cost savings to participants.

Over the years, there has been much debate about the trend of retirement ages. For many years, the belief was that the trend was very much towards retirement at younger ages. However, over recent years and in the current economic climate, many believe that sentiment has changed and the trend is now for longer participation in the workforce.

The age at which most superannuation benefits become tax free, whilst consistent with the long term preservation age, is inconsistent with the retirement age for age pensions:

- the age pension age is currently 65 for males and 63.5 for females. The latter is scheduled to increase to age 65 by 1 January 2014; and

- the current preservation age in the superannuation system is 55 for all members and this is scheduled to increase to age 60 by 1 July 2024.

We believe that consistency across the various ages may be an appropriate long term goal for all compulsory SG contributions, any lump sum payment and the government provided age pension. This would result, over time, in increases in the preservation age and the age at which most superannuation benefits become tax free.

7. Elevation of caps

Simplified Superannuation permits indexation of the concessional contributions limit and the cap on non-concessional contributions in $5,000 increments. The Taxation is concerned that this indexation model has the capacity to punish people over time by creating limits and caps restrained by static $5,000 increments. We recommend that the operation of this model be reviewed on a timely basis to ensure that it is not adversely impacting on taxpayers.

8. Preservation and non-concessionals

There is a significant disincentive or an inadequate incentive for taxpayers, particularly small business owners, to make non-concessional contributions to superannuation where it is then subject to preservation and cannot be generally accessed until preservation age.

Given the financial risks that taxpayers face over their lifetime there is a natural reluctance to put savings into a preserved and non-accessible environment notwithstanding that such savings may attract a lower rate of taxation.

We suggest that consideration be given to allowing access to non-concessional contributions by removing the release conditions that apply to those amounts. The earnings on those amounts should be required to be retained in the superannuation system and be subject to preservation; so these earnings are locked in to the superannuation system. We expect there may be significant growth in investments made into the superannuation system if such contributions were made accessible. The contribution limits provide a natural guard against taxpayers seeking to abuse such a facility.

9. Co-contribution

We support the retention of the current co-contribution scheme.

Consideration should be given to allowing individuals to make "catch-up co-contributions" to encourage those who have been out of the workforce or otherwise on low or nil incomes for extended periods (for example due to parental leave) to access the co-contribution, so as to provide an incentive for those individuals to increase the level of their superannuation savings.

It may be necessary to impose limits on the period of time for which individuals would be entitled to make "catch up co-contributions". For example, it may be appropriate to limit the period to the time the individual was out of the workforce, or on low income.

The "catch up co-contributions" should be made available beyond the current cap for co-contributions of $60,342 (for assessable income and reportable fringe benefits). It may be that an averaging of the individual's income be considered, say, over the preceding 5 years.

Appendix – the Taxation Institute's Superannuation Subcommittee

Set out below are the current members of the Taxation Institute's Superannuation Subcommittee:

Daniel Butler
DBA Butler Pty Ltd

Elizabeth Goddard
Chartered Accountant

Suzanne Mackenzie
DMAW Lawyers

Neil Howard
HLB Mann Judd

Martin Heffron
Heffron Consulting

Neal Dallas
McCullough Robertson Lawyers

Greg Rowsell
Deloitte Touche Tomhatsu

Shayne Carter
Greenwoods & Freehills

Mark Payne
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Graeme Halperin
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