



The Voice of Super

Pre-Budget Submission for the 2008–09 Budget

Association of Superannuation Funds
of Australia

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Federal Secretariat

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Executive Summary

ASFA's mission is to protect, promote and advance the interests of Australia's superannuation funds, their trustees and their members. As such it is the "Voice of Super". This mission includes enhancing the financial security and retirement income of all Australians.

This document sets out a number of measures that could be adopted in the Budget and which would lead to greater adequacy of retirement incomes. The proposals have been carefully costed, and market research conducted for ASFA shows significant support for the proposals in the community.

ASFA proposes that new default arrangements (soft compulsion) be introduced so that individuals' superannuation contributions are increased above 9% unless they opt out from the arrangement. The extra contributions would start when an employee commences a new job or receives a pay increase and would come from the employee's remuneration.

The superannuation co-contribution also has been a remarkably successful measure which has been highly visible and which has directly contributed to more adequate retirement savings. Its success should be built upon by changing the eligibility criteria for this scheme to allow more low to middle income earners to have access to the maximum \$1,500 contribution from the government. For a relatively modest budget cost, the ASFA proposed changes to the co-contribution would have the potential to boost the retirement savings of a person on \$40,000 a year by nearly 10%.

ASFA also proposes two other measures. One is aimed at facilitating salary sacrifice contributions into superannuation. The other would extend the range of death and disability benefits that are tax free to the recipient.

The specific recommendations follow:

RECOMMENDATION 1

ASFA recommends that the Government require or encourage employers to introduce new default arrangements where an extra 1% of salary or wages is put into superannuation each time the employee receives a wage increase or starts a new job, up to a maximum of 3% (in addition to the compulsory 9% SG). Employees could choose to opt out from such an arrangement if they desired.

RECOMMENDATION 2

That the level of annual income at which the full co-contribution can be received be increased to \$40,000 per year so that more individuals on low/middle incomes can receive significant assistance, with the phase-out rate for the co-contribution adjusted so that individuals with an income of up to \$60,000 per year can qualify for at least a partial co-contribution.

RECOMMENDATION 3

ASFA recommends that the Government legislate to require employers to provide salary sacrifice arrangements for an employee when and if requested by an employee.

RECOMMENDATION 4

ASFA recommends that death benefits be paid tax-free where the member dies at age 60 or above regardless of whether the recipient is a dependant or non-dependent under the ATO definition and that all disability benefits taken in income stream form also be paid tax-free.

The Association of Superannuation Funds of Australia (ASFA)

ASFA's mission is to protect, promote and advance the interests of Australia's superannuation funds, their trustees and their members. As such it is the "Voice of Super". This mission includes enhancing the financial security and retirement income of all Australians.

ASFA member funds are responsible for the vast majority of assets and members in each of the retail, public sector, corporate and industry fund sectors. ASFA also has a strong representative function for the 25% or so of assets held by Self Managed Superannuation Funds (SMSFs) and for the members of such funds given that many of the major advisory firms for SMSFs are members of ASFA. ASFA member funds in aggregate represent over 80 per cent of Australians with superannuation, and the bulk of the \$1.2 trillion in superannuation assets as at September 2007.

1. Why increased retirement savings are needed

Research commissioned by ASFA which was undertaken in September 2007 by the polling organisation ANOP indicates that around 65% of the population do not consider that their savings for retirement will be adequate. As well, a proportion of the 35% of respondents who consider that they are saving appropriately are likely to be mistaken. Only a minority of members of the paid labour force make or have made on their behalf contributions in excess of the legal minimum of 9% of wages. Around 22% of the workforce make salary sacrifice contributions.

Calculations by the ASFA Research Centre illustrate the greater and the earlier additional superannuation contributions are made, the more likely an adequate retirement income, which may include the Age Pension, will be achieved.

In brief, the calculations show:

- Achieving a gross income in retirement of \$21,000 (or 60% of pre-retirement income of \$35,000) requires contributions at 9% of wages for at least 35 years.
- Contributions above the 9% Superannuation Guarantee level are needed for most income earners and retirement targets, or where full-time employment amounts to less than 40 years.
- Putting off an increase in contributions from 9% to 15% for, say, five years means the increase then needs to be to 18%. Compound interest and additional years of higher contributions are powerful forces.

Table 1 outlines the amount that needs to be saved above the current 9% SG level to achieve certain retirement income targets. The estimates in the table take into account the abolition of the tax on superannuation benefits received at age 60 and older, as well as the easing of the assets test for receipt of the Age Pension.

TABLE 1**Extra percentage of income to be saved for 60% of pre-retirement income**

Years to retirement	Final Income (Retirement income sought)		
	\$35000 (\$21000)	\$50000 (\$30000)	\$75000 (\$45000)
20	10%	17%	22%
25	5%	10%	14%
30	2%	6%	10%
35	0%	3%	6%
40	-	1%	3%

Assumptions: 9% SG already paid by employer, includes value of age pension, nominal fund earnings of 7% after fees and taxes, and 15% contributions tax and 15% earnings tax are payable.

Another way of looking at the impact of additional contributions is to compare the lump sums generated by various levels of contribution with the lump sums needed to support a retirement lifestyle matching either a 'modest' or 'comfortable' retirement lifestyle. The Westpac ASFA Retirement Standard provides required aggregate expenditure and detailed budgets for various household types at both these levels.

Most retirees from age 65 onwards will rely at least in part on the Age Pension. Accordingly, receipt of a part-rate Age Pension is assumed in the calculations of the lump sums needed set out in Table 2.

For both a single person and a couple, a lump sum of around \$100,000 is required to support expenditure in retirement consistent with a 'modest' lifestyle, namely \$26,639 a year for a couple and \$18,742 for a single person as at September 2007. The reason for this is that the Age Pension provides most of the necessary income.

For a 'comfortable' lifestyle, larger retirement savings are needed. For a single person the amount required is around \$500,000 (assuming nominal investment returns of 7% per annum), while for a couple the amount is just over \$500,000. Receipt of the Age Pension at the couple rate means the amount to be saved by a couple is not double the amount needed by a single person.

Even a person on a salary of \$100,000 a year would need to make contributions at the rate of 12% or more to achieve a 'comfortable' standard of living in retirement, assuming he or she was single or the only person with superannuation within a couple household.

For a person on \$50,000 a year, contributions in the order of 20% per year over 30 years would be needed to support a 'comfortable' lifestyle in retirement.

Alternatively, if both members of a couple had incomes of \$50,000 a year and each made total contributions (including the SG) of between 11% and 12% per year, they would be able to achieve a ‘comfortable’ lifestyle. Of course, some single persons and couples might be assisted in achieving their retirement savings from receipt of an inheritance or from savings outside the superannuation regime.

TABLE 2: Lump sum retirement benefits after 30 years in a taxed fund for a person aged 60 or over (a)

Tax treatment	Wage of \$30,000	Wage of \$50,000	Wage of \$100,000
Contributions and investment earnings taxed at current rates	\$110,000	\$183,000	\$366,000
Pre 1 July 2007 net amount after benefits tax on lump sum	\$110,000	\$174,214	\$327,018
Improvement after 1 July 2007 with no benefits tax	Nil	\$8,786 (5.0%)	\$38,982 (11.9%)
Lump sum if contributions made at the rate of 12% of salary	\$146,000	\$244,000	\$487,000
Lump sum needed to support comfortable lifestyle (assumes receipt of part Age Pension).	\$500,000	\$500,000	\$500,000

(a) All figures in today's dollars (using 3.75% AWE as a deflator), investment earning rate of 7% assumed.

A package of proposals that addresses the adequacy of retirement savings and income at the individual level can be expected to receive strong support from the community. It also would be sound public policy in terms of bringing about more adequate retirement incomes and reducing pressures on Age Pension expenditures.

Measures to boost contributions

ASFA has argued in Pre-Budget submissions in earlier years and in submissions to the then Senate Select Committee on Superannuation that in order to better meet retirement income needs and expectations, contributions would have to be increased to an amount equivalent to 12% to 15% of wages through a combination of compulsory contributions, voluntary contributions and/or tax relief.

Accordingly, in this submission ASFA is focussing on Budget measures which would facilitate additional net contributions as a way of improving adequacy. These proposals relate to enhancing the current co-contribution and reducing or eliminating the tax paid at the fund and employee level on employer and other superannuation contributions.

2. Specific ASFA proposals for the 2008-09 Budget

ASFA is conscious that any Budget proposal needs to be both affordable and politically viable. Accordingly, we have given careful consideration to the costs of our proposals, and undertaken analysis of the groups who would particularly benefit from adoption of the measures.

2.1 Introducing “soft compulsion” for additional superannuation contributions

Both the co-contribution and tax concessions applying to salary sacrifice have led to a significant number of individuals making contributions to superannuation over and above the 9% of wages Superannuation Guarantee contributions made on behalf of most employees. However, a large majority of employees make no contributions over and above what their employer is obliged to make

The introduction of compulsory superannuation and its phased increase to its current level occurred in the context of industrial and economic environments specific to their time. ASFA is not proposing in this submission that employers be required to increase their level of compulsory contributions. Rather it is proposing a program of what can be described as “soft compulsion” for employees. This involves employees making additional contributions over above the Superannuation Guarantee rate of 9% of wages or salary unless they opt out.

Soft compulsion is an approach that is increasingly being used around the world, including in a number of countries which have considerable attachment to free markets and making use of market forces. For instance, in the United States of America many employers make use of arrangements described in various ways, including “SMART plan”, “Escalator” or “Quick Enrolment” depending on the entity promoting the arrangement. The recently introduced Kiwisaver scheme in New Zealand involves soft compulsion, and the United Kingdom government has also foreshadowed the introduction of soft compulsion for employees with effect from the year 2012.

A common feature of such arrangements involves employees committing a part of their annual wage rise to be deducted and paid into the retirement plan. Employees can opt out of the arrangement at any time. Typically takeup rates are at least the 70% or so level and can be even higher, with relatively low rates of attrition. What individuals do not receive in the hand but is saved instead does not appear to be unduly missed.

Both overseas experience with such arrangements and behavioural finance theory indicate that soft compulsion is an effective and well accepted mechanism for increasing retirement savings. In terms of behavioural finance, soft compulsion:

- Stops people delaying decision making because of the complexity of the task.
- Gets around the human foible of putting off until tomorrow what they are not really motivated to do today.
- Provides defaults which are seen as more or less officially approved savings options, but with no government liability attached.

Soft compulsion was recommended by the House of Representatives Standing Committee on Economics, Finance and Public Administration in its report of its inquiry “Improving the superannuation savings of people under 40”. The Committee recommended that when a new employee commences work they are automatically placed in a ‘voluntary’ contribution arrangement which they could choose to opt-out of at any time, preferably operating through salary sacrifice. The Committee suggested that the starting point in savings contributions could be a default rate of three per cent with periodic adjustments.

ASFA tested community reaction to such a proposal in its 2007 ANOP survey. Respondents were asked about the idea of putting “an extra 1% into super each time you receive a wage increase or start a new job, up to a maximum of 3%”. It was also mentioned to those polled that this would be on top of the 9% compulsory superannuation but you could choose to opt out. The extra contribution would come from the employee’s salary, and would not be an additional employer payment or cost.

The survey found very strong support for such a proposal, with 86% of respondents indicating that such a form of soft compulsion was a good idea. Support was even higher amongst those aged 25 to 39, with an 89% approval rating. Each of these figures is up a little on the year before.

When respondents were asked for their unprompted reasons for their attitude to soft compulsion, the main reasons identified were:

- That it’s a good boost to super.
- That you can opt out.
- That it’s an acceptable means of lock-in at a time when you can afford it.
- That it’s at a level that would not be missed.

The reasons given indicate respondents had a good understanding of the proposal, and that the behavioural finance theory applies in practice.

Importantly, adoption of soft compulsion in the 2008 Budget would signal to individuals, particularly younger workers, that the norm for saving for retirement should be at least 12% of wages, not the 9% as currently set by the Superannuation Guarantee. The need and desirability of contributions in excess of 9% has been recognised in the contribution and benefit design structures of the various superannuation schemes covering Commonwealth public servants and Commonwealth parliamentarians.

Recommendation 1: ASFA recommends that the Government require or encourage employers to introduce new default arrangements where an extra 1% of salary or wages is put into superannuation each time the employee receives a wage increase or starts a new job, up to a maximum of 3%. Employees could choose to opt out from such an arrangement if they desired.

2.2 Providing a more effective co-contribution

The public opinion research commissioned by ASFA has consistently indicated that there is a very high level of support in the community for greater self-reliance in retirement, provided the responsibility is shared with government through more incentives to save for retirement.

The superannuation co-contribution has recognised Australians' widely based support for mutual obligation, in which individuals save more for their retirement in return for greater support from government. The 2007 ANOP polling indicates that nearly 85% of the community are aware of the co-contribution, and one in three have received a benefit from the co-contribution or a member of their family has. In the last financial year there were over 1.1 million recipients of the co-contribution in regard to contributions made in the 2005-06 financial year.

ASFA strongly recommends that the current co-contribution be built upon as a strategy to increase contributions to superannuation.

The current co-contribution applying to contributions made in 2007-08 and later years provides for a maximum co-contribution of \$1,500, with this available for persons with assessable income and reportable fringe benefits of less than \$28,980 a year. The government co-contribution matches the personal contribution of the superannuation fund member on a \$1.50 for each dollar contributed by the member basis.

The maximum co-contribution phases down with increasing income, at a rate of 5 cents in the dollar. For individuals on \$58,980 per annum and above no co-contribution is available. The maximum co-contribution is also very modest for those with income of more than \$50,000 per year.

ATO and survey data clearly indicate the co-contribution has been well received, and has been well understood and used. The main thing holding back further use of it by the community is the current means testing, with the potential value of the co-contribution phasing down once an individual has an income in excess of \$28,980 per year. While the extension of the co-contribution from 1 July 2007 to the self employed is welcome, a further extension is both feasible and desirable.

Extension of the co-contribution

ASFA's proposal is that additional contributions be further encouraged and supported as part of a process of mutual obligation by broadening the eligibility criteria for co-contribution. ASFA considers that it is this middle income group which deserves assistance, especially given that they have not benefited from either the abolition of the superannuation surcharge or the initial two versions of the co-contribution. Many middle income earners will also receive minor or even no benefits from the abolition of the tax on superannuation benefits received after age 60, especially if they do not have or will not have 35 or more years in the paid labour force.

The co-contribution is already a very useful supplement to retirement savings and an incentive for additional savings by low income earners, but ASFA considers that it

should be enhanced so as to provide greater incentives for both low and middle-income earners. There is both need and scope to provide greater assistance to individuals with a taxable income between \$40,000 and \$60,000 a year.

Recommendation 2: ASFA recommends that the level of annual income at which the full co-contribution can be received be increased to \$40,000 per year so that more individuals on low/middle incomes can receive significant assistance, with the phase-out rate for the co-contribution adjusted so that individuals with an income of up to \$60,000 per year can qualify for at least a partial co-contribution.

More specifically, it is recommended that for contributions made in 2008-09 and later years the maximum co-contribution remain at \$1,500, but this be available for persons with assessable income and reportable fringe benefits of \$40,000 a year or less. It is also recommended that the maximum co-contribution phase down as income exceeds \$40,000 a year, at a rate of 7.5 cents in the dollar. Consistent with current legislated indexation arrangements for the co-contribution, ASFA also would propose that the lower and upper thresholds be adjusted from 1 July 2009 in line with growth in average weekly ordinary time earnings.

As with the various thresholds and limits in the Simplified Superannuation package which are indexed, it would be desirable to round the upper and lower limits after indexation to the nearest thousand dollar figures in order to maintain simplicity.

Table 3 below illustrates the maximum co-contribution that would apply at various income levels if the ASFA proposal were adopted. The ASFA proposal would deliver benefits to those who are in need of higher retirement income savings and who have some capacity to make additional contributions themselves. ASFA's ANOP survey results also show the preparedness of many in this middle income group to make use of the measure.

Table 3: ASFA proposed parameters for the superannuation co-contribution

Income level (assessable income plus reportable fringe benefits) per annum	Proposed maximum co-contribution currently applying to contributions in 2006-07 and later years	Amount of personal contribution needed to achieve maximum co-contribution
\$40,000 and below	\$1,500	\$1,000
\$45,000	\$1,125	\$750
\$50,000	\$750	\$500
\$55,000	\$375	\$250
\$60,000	0	

In extending the parameters of the scheme the Government would make clear its commitment to providing real support and encouragement to voluntary saving for retirement by low and middle income earners.

As shown by Table 4, the greatest benefits in both absolute and relative terms would be delivered to those in the \$40,000 to \$50,000 a year income group.

Table 4: Impact of ASFA proposed parameters for the superannuation co-contribution

Income level (assessable income plus reportable fringe benefits) per annum improvement	Projected lump sum retirement benefit after 30 years contributions – current parameters	Projected lump sum retirement benefit after 30 years contributions –ASFA proposed parameters	Percentage
\$35,000	\$224,000	\$227,000	1.3%
\$40,000	\$235,000	\$255,000	8.5%
\$45,000	\$246,000	\$262,000	6.5%
\$50,000	\$257,000	\$269,000	4.7%
\$55,000	\$268,000	\$275,000	2.6%
\$60,000	\$282,000	\$282,000	0

Source: Projections obtained from ASIC Superannuation Calculator on www.fido.gov.au. Assumes personal contribution of \$1,000 per year, and invested in balanced option.

On the basis of information available on the number of taxpayers in the various income bands, the propensity of low to middle income earners to make personal contributions, and the experience with the previous extension of the co-contribution, extension of eligibility along the lines proposed by ASFA would involve a budgetary cost in the order of \$600 million per year.

2.3 Requiring all employers to allow employees to make salary sacrifice contributions to a superannuation fund

Survey data collected in September 2007 for ASFA by ANOP indicates that 23% of the workforce currently engage in some sort of salary sacrifice arrangement. The incidence of this increases with age. Only 18% of those aged 25 to 39 undertake salary sacrifice, rising to 26% for those aged 50 to 69. For those with household income under \$60,000 per year salary sacrifice was relatively low in incidence, with a rate of 19%. However, 31% of respondents with household income over \$100,000 reported that they made salary sacrifice contributions.

Employer attitudes and the level of financial literacy of individuals also are important. Around one in five (22%) of the workforce reported being denied the opportunity by their employer to make salary sacrifice contributions or were unaware of the potential to do so. Equity considerations arise when employees are denied the opportunity to salary sacrifice. If an employee is not eligible to receive the co-contribution or already is making sufficient personal contributions to qualify for the co-contribution then it will generally be more financially attractive to make salary sacrifice contributions. For some employees to be denied this opportunity means that they are treated inequitably compared to those who can salary sacrifice and receive the tax benefits inherent in that practice.

Clearly the Commonwealth has the power to require incorporated employers to offer salary sacrifice arrangements to all employees. The costs for employers in complying with such a provision would be relatively modest as they would already in most instances be making contributions to a superannuation fund in order to satisfy their Superannuation Guarantee obligations.

As well, compliance costs in offering salary sacrifice arrangements could be reduced by incorporating such an offer in the standard choice form made available to new employees.

Consequential amendments to the Superannuation Guarantee legislation would also be required to specify that the earnings base for the Superannuation Guarantee is the amount of wages or salary before any salary sacrifice arrangement is entered into. Such amendments would make it clear that entering into a salary sacrifice arrangement does not lead to any diminution of Superannuation Guarantee contributions. There also might be a need for consequential amendments to Commonwealth and State industrial relations legislation to ensure that salary packages and minimum or set wage rates could be altered in the way suggested.

Recommendation 3: ASFA recommends that the Government legislate to require employers to provide salary sacrifice arrangements for an employee when and if requested by an employee.

2.4 Taxation treatment of death and disability benefits

Death benefits

The Simplified Superannuation changes to the taxation of benefits led to much simpler tax treatment of personal superannuation benefits taken by persons aged 60 and over. However, there is complexity and different levels of taxation when a death benefit is taken by an individual who is not a dependant or interdependent. This complexity is even greater when part of such a benefit is funded by an insurance policy.

In regard to the payment of tax on death benefits received by non-dependants, this is only likely to occur in the case of superannuation accounts held by person aged 60 and over when that person dies unexpectedly and/or without receiving financial advice. For those who are in a position to plan, the new benefit tax arrangements will lead a new version of the “recontribution” strategy. Members will withdraw their benefits at age 60 and either keep them outside the superannuation system or recontribute all or part of the account balance so that the new undeducted (non-concessional) contribution becomes an exempt component. Such an exempt component is tax free when it is paid as a death benefit to a non-dependent adult child or other non-dependent beneficiary.

The amount of taxation collected from death benefits paid to a non-dependant where the account holder was aged 60 and over is likely to be quite small in aggregate. Most death benefits go to a dependant and/or are relatively modest in nature. Those with

larger balances who have non-dependants as a beneficiary will often take advice and put in place recontribution strategies.

ASFA considers that this has led to inequity between beneficiaries depending on whether the superannuation account holder has put into place effective financial planning. ASFA recommends that death benefits be paid tax-free where the member dies at age 60 or above regardless of whether the recipient is dependant or non-dependant under the ATO definition.

Disability benefits

A disability benefit from a superannuation fund is tax free if received by a fund member who is aged 60 and over. For persons aged under 60 receiving an income stream disability benefit, the income stream forms part of their taxable income but a 15% tax rebate is available.

The tax treatment of lump sum disability benefits received under age 60 is complicated. A tax threshold applies between preservation age and age 60, and the taxable amount is determined by taking into account the tax free component. The tax free component in part depends on the total service days in employment and the number of days to retirement.

Clearly the current structure for the taxation of disability benefits is complex. It also leads to inequities between individuals who are in very similar circumstances but face widely different tax bills because they are a slightly different age, or have more or less past years of employment.

Little tax is likely to be collected currently from individuals receiving disability benefits in income stream form. This is because of the tax rebate available, and the fact that the vast majority of those who are permanently disabled from working have low taxable incomes.

ASFA recommends that on the grounds of both simplicity and equity that all total and permanent disability benefits paid in income stream form be tax free regardless of the age of recipient. ASFA is not proposing that the tax on lump sum disability benefits be abolished at this stage. ASFA considers that an incentive should be retained for taking disability benefits in income stream form.

Recommendation 4: ASFA recommends that death benefits be paid tax-free where the member dies at age 60 or above regardless of whether the recipient is a dependant or non-dependent under the ATO definition and that all disability benefits taken in income stream form also be paid tax-free.