

Pre-Budget Submission for the 2009-10 Budget

Association of Superannuation
Funds of Australia
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Executive Summary

ASFA's mission is to advance effective retirement outcomes for members of funds through research and advocacy and to serve ASFA members by providing a range of services. 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 costed and are entirely affordable even in the current stringent budgetary circumstances.

This year's Pre-Budget Submission from ASFA takes into account that the Review into Australia's future tax system (the Henry Review) has been requested by the Treasurer to bring forward its consideration of the retirement income system and report to the Government by the end of March 2009. Accordingly this year's Pre-Budget Submission will be relatively brief. The bulk of our recommendations for improving the adequacy of retirement incomes will be contained in the ASFA submission to the Henry Review.

However, a number of more immediate issues are canvassed in this Pre-Budget Submission.

First, the Simplified Superannuation changes to the taxation of benefits have 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. More specifically, ASFA considers that an inequity has developed 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 tax legislation definition.

Recommendation 1: 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-dependant under the tax legislation definition.

Second, 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. This leads to inequities between individuals who are in very similar circumstances but are a slightly different age, or have more or less past years of employment.

Recommendation 2: ASFA recommends that all disability benefits taken in income stream form be paid tax-free.

Third, superannuation funds are presently in the middle of the first period in which the Simpler Superannuation taxation measurer imposing additional taxation on certain superannuation contributions when no tax file number has been quoted has taken effect.

The experience of funds has highlighted the administrative difficulties with how the provisions work and the inequities faced by some fund members even when they eventually quote their TFN to their fund.

Recommendation 3: Revise the "No-TFN" tax arrangements for superannuation contributions in order to minimise the administrative and other costs faced by funds and the disadvantage faced by members who notify their TFN subsequent to making a contribution

Fourth, there is a danger that ill-considered cashing out of superannuation benefits will lead to individuals suffering adverse tax and investment return consequences in the future. Even for those leaving their account balance within the superannuation environment but switching to a cash or capital guaranteed investment option there is the danger that they will miss out future investment returns when equity markets recover.

While some fund members will benefit from receiving personal financial advice on such issues, others will not have access to such advice because of cost and other considerations. Accordingly there is a strong case for the government to fund the development of resources for the use by fund members and other retail investors in considering investment decisions. The private sector would be well placed to develop such resources provided that appropriate government funding was provided.

Recommendation 4: That \$10 million be provided over two years for industry bodies to undertake the preparation and dissemination of financial literacy material to assist fund members and other retail investors in appropriately responding appropriately to the inherent volatility of investment markets

Fifth, ASFA recommends that the fee arrangements relating to the Commonwealth guarantee for bank accounts be amended to provide regulated superannuation funds with the ability to look through their aggregate bank account holdings to individual members who have chosen a cash option.

On the grounds of competitive neutrality with Self Managed Superannuation Funds and to avoid members being in effect encouraged to invest directly in bank accounts outside of superannuation, no fee should be charged for that part of a superannuation fund's bank account attributable to members choosing to invest in a cash option. Such a fee arrangement would be totally consistent with the policy thrust of the measure and would not involve a guarantee in any way for an equity market linked investment.

Recommendation 5: That superannuation funds not be required to pay a bank deposit guarantee fee for that part of their bank accounts attributable to superannuation fund members who have chosen a cash investment option with the fund

The Association of Superannuation Funds of Australia (ASFA)

A key part of ASFA's mission is to advance effective retirement outcomes for members of funds.

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 30% 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 members in aggregate represent over 80 per cent of Australians with superannuation, and the bulk of the \$1.15 trillion in superannuation assets as at September 2008.

1. Relationship between the ASFA Pre-Budget Submission and the ASFA Submission to the Review into Australia's Future Tax System

An important part of the context for this year's Pre-Budget Submission is that the Review into Australia's future tax system (the Henry Review) has been requested by the Treasurer to bring forward its consideration of the retirement income system and report to the Government by the end of March 2009. The findings of Dr Harmer's review of pensions will also be available then.

ASFA has already provided a preliminary submission to the Review. Key points raised in that submission are at Appendix A. ASFA also is currently developing a more detailed submission which will amongst other things address the specific questions posed in the December 2008 Retirement Income Consultation Paper.

Accordingly this year's Pre-Budget Submission from ASFA will be relatively brief. The bulk of our recommendations for improving the adequacy of retirement incomes will be contained in the ASFA submission to the Henry Review. This Pre-Budget Submission will focus on more immediate issues, including some fund operational issues.

2. Specific ASFA proposals for the 2009-10 Budget

ASFA is conscious that any Budget proposal needs to be both affordable and politically viable. This is especially the case in the current challenging economic and financial climate. 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 Remove tax on death benefits (including any insurance payout) payable in regard to the death of a person aged 60 or over

Rationale

This is consistent with stated policy of the maintenance of no tax on superannuation benefits paid by a taxed fund to a person aged 60 and over.

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 a 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 to 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 tax legislation definition.

Recommendation 1: 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 tax legislation definition.

2.2 All Total and Permanent Disablement Benefits paid in income stream form to be tax free regardless of the age of the recipient. Tax on lump sum benefits remains before age 60.

Rationale

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. This leads to inequities between individuals who are in very similar circumstances but face different tax bills because they are a slightly different age, or have more or less past years of employment.

A specific problem that has arisen is that individuals with very serious illnesses can have difficulties in getting a doctor to

certify that they have a terminal illness. More appropriate taxation treatment of disability benefits would relieve such individuals from the necessity to make distressing applications for release of benefits on the grounds of terminal illness.

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 and unable to work have low taxable incomes.

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.

We believe the cost to Government would be very small as currently not much tax is collected from disability income recipients.

Recommendation 2: ASFA recommends that all disability benefits taken in income stream form be paid tax-free.

2.3 Review the no-TFN and superannuation contributions taxation policy with a view to obtaining a simpler and more equitable system.

Rationale

Funds are presently in the middle of the first period in which this tax measure is taking effect. As a result they are experiencing first hand the various administrative issues associated with it, including:

- Inability of the offset to be applied where the fund that initially received the no-TFN contribution no longer exists. Several large fund mergers as at 30 June 2008 mean that this already has the potential to be a significant issue.
- Considerable difficulties with the 30 June cut-off date each year for relatively new employees or new members.
- Determination of the appropriate time to credit a member's account with the offset (automatically on receipt of TFN, or a considerable time later (often more than 18 months) when the tax benefit of the offset is received from the ATO), and the implications of this decision for other members within the fund.
- Where no-TFN tax has been paid by a fund and the fund subsequently becomes part of another fund through a successor fund transfer there is no scope for a refund of that tax by the ATO even if a TFN is quoted.
- The application of the tax to members within defined benefit funds is far from certain.
- The equity issues that arise from the application of the tax to "insurance only" members of funds, where the inclusion of a member is mandatory because of the fund's relationship (eg, default fund) with the particular employer. The result is a tax bill for the fund, in circumstances where the fund has no money with which to pay this bill, and yet where the fund had no way of rejecting the receipt of the employer's contribution.

Recommendation 3: Revise the "No-TFN" tax arrangements for superannuation contributions in order to minimise the administrative and other costs faced by funds and the disadvantage faced by members who notify their TFN subsequent to making a contribution

2.4 Provide funding for the provision of financial literacy material for fund members

Rationale

In October 2008 the Government announced additional funding to APRA and ASIC of \$83 million over four years to ensure that the regulators have sufficient resources to fulfil their roles in the light of global developments.

The funding for ASIC will be primarily used for additional 'front-line' resources for market monitoring and enforcement activities.

While what was announced will assist in maintaining the strength of Australia's financial system during the global financial crisis there is also a need for enhanced financial literacy activities to assist superannuation fund members and other retail investors in Australian financial markets to make informed decisions about investment choice and whether to make voluntary contributions.

In particular, there is a danger that ill-considered cashing out of superannuation benefits will lead to individuals suffering adverse tax and investment return consequences in the future. Even for those leaving their account balance within the superannuation environment but switching to a cash or capital guaranteed investment option there is the danger that they will miss out on future investment returns when equity markets recover.

While some fund members will benefit from receiving personal financial advice on such issues, others will not have access to such advice because of cost and other considerations. Accordingly there is a strong case for the government to fund the development of resources for the use by fund members and other retail investors in considering investment decisions. The private sector would be well placed to develop such resources provided that appropriate government funding was provided.

Materials on what individuals should take into account when contemplating altering current superannuation investments or making further superannuation contributions could be published and disseminated in a variety of ways. Such materials would have the potential to provide considerable assistance to investors and to lead to more appropriate investment behaviour. While of specific assistance to fund members in the context of current financial market developments, provision of such materials would also be valuable to fund members on an ongoing basis.

Recommendation 4: That \$10 million be provided over two years for industry bodies to undertake the preparation and dissemination of financial literacy material to assist fund members and other retail investors in appropriately responding appropriately to the inherent volatility of investment markets

2.5 Remove the charge made by the government for the bank guarantee when a superannuation fund has members who have chosen a cash investment option

Rationale

Currently the deposit guarantee is available at no charge to a Self Managed Superannuation Fund which holds a bank deposit of less than \$1 million. In contrast, an APRA regulated superannuation fund with multiple members who have chosen a cash option and who each have less than \$1 million in their account is required to pay the fee for guarantee if they wish to receive the benefit of the guarantee. In the case of such funds the trustee of the fund is the legal owner of the deposit investment. However, the fund administers separate records of individual members' holdings which contribute to the overall deposit held by the fund.

In these circumstances the 'free' Government guarantee only applies if \$1 million or less in aggregate is held in a bank deposit by the super fund. So once \$1 million is breached, if the fund wants to offer members access to the guarantee in regard to accounts totally invested in cash with a bank it would need to charge a blanket 0.70% cost to the relevant members regardless of the size of their account holding.

ASFA recommends that the fee arrangements be amended to provide regulated superannuation funds with the ability to look through their aggregate bank account holdings to individual members who have chosen a cash option.

On the grounds of competitive neutrality with Self Managed Superannuation Funds and to avoid members being in effect encouraged to invest directly in bank accounts outside of superannuation, no fee should be charged for that part of a superannuation fund's bank account attributable to members choosing to invest in a cash option. Such a fee arrangement would be totally consistent with the policy thrust of the measure and would not involve a guarantee in any way for an equity market linked investment.

Given that only a very small proportion of superannuation fund members choose a cash investment option within a fund involving an ultimate bank deposit holding by the fund the costs to revenue of the suggested change to the fee would be very modest.

Recommendation 5: That superannuation funds not be required to pay a bank deposit guarantee fee for that part of their bank accounts attributable to superannuation fund members who have chosen a cash investment option with the fund

APPENDIX A

ASFA Submission - Henry Review – Summary

Our aim in this initial submission was to focus on some big-picture themes and areas. ASFA is currently developing its specific recommendations to the Review in response to the consultation papers released in December 2008.

We are pleased that adequacy of superannuation was included in the scope of this review so that retirement incomes can be considered in a holistic way. This means

that our recommendations were not solely on taxation issues – we were also looking at the adequacy of superannuation and its integration with social security.

Our recommendations were all aimed at achieving the four key policy outcomes of:

- *Simplicity* of the superannuation system
- *Fairness* – giving all Australians a tax incentive to make contributions to super
- *Coverage* - ensuring all Australians of working age are covered by super
- *Adequacy of superannuation* – giving all Australians the best chance of retiring with an adequate retirement income.

The Current System

Overall we support the current structure of the superannuation system. We recognise that there is a combination of support for Australians for retirement made up of, a tax-advantaged superannuation system with the safety net of the Age Pension for those who are unable to self-fund an adequate retirement income.

Key Themes of this Submission

There are, however, some areas in which we believe the system can be enhanced. Following consultation with our members, we focused on the issues within three key themes:

1. Contributions and Adequacy of super;
2. Participation of the Ageing Workforce; and
3. Income Streams in Retirement & Longevity Risk.

Within each of these areas we described some guiding principles for changes to the retirement income system and then suggested some measures.

The second part of the submission addressed more detailed issues including, the tax treatment of investments by superannuation funds, transfers from overseas funds, issues where no Tax File Number has been quoted and a number of matters relating to the operation of the Superannuation Guarantee.

1. Contributions & Adequacy

Guiding principles:

- All Australians should be covered by compulsory superannuation or be provided with superannuation credits.
- The current 9% superannuation guarantee contribution is not enough to provide an adequate retirement outcome for the vast majority of Australians. Our view for some time has been that we need an effective 15% contribution rate by 2015.
- Superannuation contributions are preserved until age 60. Individuals should be compensated for this lack of access by being given a tax advantage on their superannuation contributions such that the rate of tax is lower than their marginal rate.

- Given the need to improve adequacy and reach a higher effective savings rate, additional contributions by individuals should be encouraged. To achieve this, individuals should be given a tax advantage on their superannuation contributions such that the rate of tax is lower than their marginal rate.
- All Australians should have equal ability to make tax advantaged contributions to super. Where an individual's employer does not offer salary sacrifice, other tax advantages should be offered so that the individual is not worse off.
- An individual's ability to make additional contributions to superannuation depends on their life stage and so contributions cannot always be made smoothly from year to year. The limits and incentives need to allow for variability in contributions at different life stages.

2. Contributions & Adequacy

Guiding principles:

- Due to the impending skills shortage with the baby boomers reaching retirement and due to increasing life expectancy, the system should be designed to encourage people to continue working beyond age 65 if they are able to. People who are unable to continue working should be supported.
- The social security and taxation system for those aged 65+ should be considered simultaneously.
- Transparent, well understood incentives for continuing to work.
- Transparent, well understood incentives for delaying taking the Age Pension whether working or not.

3. Income Streams in Retirement and Longevity Risk

Guiding principles:

- Increasing life expectancy means that longevity risk needs to be addressed.
- Individuals need to be able to defray longevity risk by accessing, on a cost effective basis, retirement products that provide longevity insurance or a guaranteed income for life.
- Given tax concessions for superannuation, individuals should be using it as retirement income.
- Remove impediments to product innovation to address Longevity Risk.
- Financial advice on a fee-for-service basis to be tax deductible