

Pre-Budget Submission for the 2010–11 Budget

ASFA Submission

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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 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) was received by the Treasurer in December 2009, along with the interim report of the Review on retirement income strategic issues in May 2009. While ASFA appreciates that a number of the recommendations of the Review may not be dealt with in the context of the May 2010 Budget (and in fact may not be fully considered for a period of some years), the Budget provides an opportunity to endorse (or reject) important recommendations made by the Review.

Recommendation 1: ASFA recommends that an additional contribution of 3% of salary be introduced, taking total contributions to 12%.

Recommendation 2: For self-employed people, ASFA recommends that:

- a compulsory contribution is gradually introduced for self employed people:
 - o starting at 1% of taxable income in 2010-11 and
 - o rising to 9% of taxable income in 2018-19;
- the contribution would be assessed as part of the tax return process with an additional amount collected from the individual (which could be rolled over into a complying superannuation fund) if the required contributions had not been made to a complying superannuation fund.

Recommendation 3: ASFA recommends that the \$450 a month threshold be substantially reduced or abolished

Recommendation 4: ASFA recommends that superannuation continue to receive tax concessions relative to other forms of savings

Recommendation 5: The current superannuation co-contribution should be enhanced to assist the equity of tax treatment of low income earners, with current tax deductibility of superannuation contributions being maintained

Recommendation 6: ASFA recommends that the contribution caps for concessional contributions revert to \$50,000 for those aged under 50 and to \$100,000 for those aged 50 and over, or that at the very least the current transitional \$50,000 a year cap for those aged 50 and over be maintained indefinitely

Recommendation 7: ASFA recommends that there be no increase in the preservation age above age 60 and that the Government indicate that there is no intention to increase it at any time in the future

Recommendation 8: ASFA recommends that all disability benefits taken in income stream form be paid tax-free

Recommendation 9: ASFA recommends that \$300,000 in funding be provided by the government to for a project to be run by the superannuation sector aimed at increasing the efficiency with which superannuation contributions and rollovers are processed

Recommendation 10: ASFA recommends that superannuation funds be provided with permanent relief for the taxation of capital gains when assets are rolled over between superannuation funds and/or between Pooled Superannuation Trusts (PSTs) on merger of two superannuation funds

Recommendation 11: ASFA recommends that superannuation funds continue to receive the benefit of a 75% Reduced Input Tax Credit for the GST on eligible purchases by superannuation funds

The Association of Superannuation Funds of Australia (ASFA)

The Association of Superannuation Funds of Australia (“ASFA”) is a non-profit, non-political national organisation whose mission is to advance effective retirement outcomes for members of superannuation funds through research and advocacy. We focus on the issues that affect the entire superannuation industry. Our membership, which includes corporate, public sector, industry and retail superannuation funds, has as members over 90% of the approximately 12 million Australians with superannuation. ASFA members manage or advise on the bulk of the \$1.2 trillion in superannuation assets as at September 2009. ASFA is the only organisation that represents all types of superannuation funds and associated service providers.

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.

1. INTRODUCTION

The 2009-10 Budget introduced a number of superannuation measures that have been interpreted by many as altering the long held philosophy that a combination of compulsory and voluntary superannuation contributions was the means by which all Australians could achieve an adequate and dignified existence once they left the workforce.

ASFA's concern is that support for superannuation has been seriously curtailed and that what will follow will be a lack of confidence in the superannuation system and a reduction in voluntary contributions and eventual. This will lead to a greater incidence of inadequate retirement savings and retirement incomes.

At the time of preparation (January 2010) ASFA understands that the Government has received the final report of the Review Panel for Australia's Future Taxation System (the Henry Review). ASFA also understands that initial Government responses to the report will be announced by the Treasurer in late March and/or on Budget night.

Accordingly, commentary on the possible recommendations of the Henry Review and on the government response to them is necessarily speculative. However, there have been indications that the Review contemplated some winding back of the taxation concessions for superannuation contributions. The short term cost to the Budget of the tax concessions and issues of competitive neutrality across types of saving are factors which have been mentioned as forming part of the consideration by the Henry Review.

In ASFA's view a winding back of the tax concessions for superannuation contributions would be very short sighted. In contrast, a focus on the future is particularly important when superannuation and retirement incomes are concerned. It can take several decades before the benefits of tax concessions for superannuation deliver their full benefits.

As well, future changes in real incomes and living standards have important implications for both what Australians aspire to in regard to retirement incomes and what Australia can afford to finance both individually and collectively. For instance, what current workers both expect and afford is markedly different from what workers may have expected or have been able to afford 15 or 20 years ago. Superannuation and retirement income arrangements differ from most other policy settings given that they largely relate to what will happen in a number of years' time, rather than just on their impact in the current or next financial year.

For these reasons, developing a strategic vision is particularly important. This submission addresses what should be in such a strategic vision of the Government, along with specific recommendations for the 2010-11 Budget.

2. ASFA'S STRATEGIC VISION

ASFA considers that a fundamental part of any review of the retirement incomes system should be the setting of a goal for the level of retirement income to be achieved. This Budget and the Government's response to the Henry Review provides an opportunity for such a long term vision to be set, together with specification of implementation steps to be taken over future years.

The vision should not be constrained by too much focus on the current system. In essence, goals and policies should be set on the basis of what would be most appropriate for a 20 year old entering the workforce over their entire working and retirement periods.

Setting a retirement income goal

ASFA believes that all Australians should be delivered at least a modest standard of living in retirement. On our current assessment this requires a retirement income (including drawdown of capital) of the order of \$20,000 a year for a single person. This is consistent with the findings of the Westpac ASFA Retirement Standard. This should be delivered by a combination of the safety net social security pillar (the Age Pension) and a level of tax preferred mandated saving through superannuation.

A floor for retirement incomes should be “modest”. Individuals should also be provided with guidance and assistance in achieving higher levels of retirement income where this is achievable. While for some individuals contributions of 9% of earnings might be sufficient to provide the appropriate retirement income goal, for most a higher percentage will be required.

The amount of tax concession to be provided

In considering tax concessions for superannuation two issues must be weighed –

1. the importance of encouraging private provision so that future retirees can substantively achieve their goals of income in retirement and also contribute towards the country’s future economic prosperity; and
2. recognition that in a country which supports a progressive income tax, the community should not direct too much tax support towards high income earners who are likely to save or provide for themselves in retirement in any case.

A “ceiling” on the level of tax concessional retirement income is therefore supported. While there are some arguments in favour of a lifetime limit on concessional contributions being applied, such an approach is basically impractical given the abolition of Reasonable Benefit Limits and the associated reporting and recording arrangements. Equally, annual limits on concessional contributions will often be too inflexible and inequitable. Annual limits, but with some flexibility for designated groups seeking to catch-up on their retirement savings, is the suggested approach.

Providing flexibility in the amount of tax preferred saving

Currently a tax concession cap is administered through contribution limits.

However, some persons are likely to want to contribute high amounts as a catch-up mechanism for past low retirement funding, whilst others are able to make substantial long-term use of the annual allowed amounts. The current contribution caps, particularly when the transitional arrangements for those aged 50 and above expire in the relatively near future, arguably unduly limit both those wanting and deserving to make longer term use of the annual amounts allowed, and those who are wanting to catch up. If the contribution caps were reduced further this would begin to impact on a substantial number of persons in defined benefit schemes and/or receiving standard employer contributions only a little in excess of the compulsory 9% of wages.

With a vision focussed on a range of retirement incomes and annual projections of retirement income, more flexibility is needed than is provided by annual contribution caps.

Delivering better retirement income products

The great bulk of retirement income streams provided in Australia are either in the form of defined benefit pensions from mostly closed to new member funds, or from account based income streams (allocated pensions in the previous terminology).

While account based income streams provide considerable flexibility and access to good long term investment returns, they are less successful at dealing with the financial consequences of longevity or short term investment return volatility. ASFA’s long term vision is for the development of retirement income products which build on the strength of current account based products to deal with such risks. Changes in both social security and tax provisions and in consumer attitudes might be needed. When better income stream products are available, income stream products will be used more.

3. ASFA proposals for the 2010-11 Budget

3.1 Increase the default rate of superannuation contributions from 9%

The interim Henry Review report asserted rather than demonstrated that both the coverage and the rate of the SG should not be extended.

However, in that report the projected replacement rates from a combination of the Age Pension and 9% superannuation contributions were boosted, amongst other things, by using only the CPI to deflate increases in the Age Pension received after a person retires. This is not a meaningful approach given that the Age Pension moves in line with increases in average wages so as to retain a link to community living standards.

The perception is and will continue to be that the Age Pension has done no more than keep up with community standards. This certainly has been the perception of individuals and the community in the context of the recent review of Age and Carers Pensions. If that report has attempted to dismiss concerns about the level of the Age Pension by relating the current level of the Age Pension to the level of wages 20 or more years ago the review findings would have been dismissed out of hand. A more relevant set of numbers are those making use of a wages deflator. These replacement rate numbers are substantially lower at around 61% for an individual on median earnings and only around 52% for a person on average earnings. At 1.5 times average earnings the replacement rate plummets to only 42.6%. These replacement rates are low compared to the 60% to 70% of gross (pre-tax) income replacement rates generally sought in overseas countries and by financial planners in Australia for those at or slightly above average earnings.

More specifically, an individual who was on average earnings (\$60,000) retiring on \$24,500 (52% of after tax employment income) in their first year of retirement does not perceive this as involving a replacement rate of 63% on the basis that future Age Pension increases will lead to an average retirement income of \$29,700 being received over the course of retirement. The absolute level of income is also important. For a person employed at \$60,000 a year a claimed replacement rate of 63% may sound attractive, but the reality of an income of \$24,500 a year in retirement is far less attractive. Only 2% to 3% of retirees are expected to have retirement incomes in excess of \$40,000 a year even when the SG system is fully mature. The bulk of retirees are expected to have retirement incomes of less than \$30,000 a year. As well around 90% of retirees are projected to be in receipt of a full or near full Age Pension.

Accordingly, the replacement income targets inherent in the conclusions of the Henry Review's interim report are very low, both in absolute terms and as a percentage of pre-retirement income. They are below the levels consistent with meeting the needs and expectations of the Australian community.

Opinion polling conducted for ASFA by Auspoll in September 2009 found that only 12% of workers aged 25 to 69 considered that a minimum retirement income of less than \$30,000 would be sufficient to maintain an adequate lifestyle in retirement. Most (60%) expected that they will need at least \$40,000 a year in retirement.

Recommendation 1: ASFA recommends that an additional contribution of 3% of salary be introduced, taking total contributions to 12%.

The question is the mechanism through which the additional contribution should be delivered.

ASFA believes that increasing SG is the preferable method of implementation. However, we understand the perceived difficulties around an increase to the SG (including political considerations and employer concerns), so if this is not possible then our next preference is for a compulsory additional personal contribution.

Our third preference is for a "soft compulsion" personal contribution where individuals would be able to opt out from making additional contributions if they so chose.

The impact of soft compulsion on disposable incomes during working years is relatively modest. For instance, for a person on average earnings an additional 1% going into superannuation leads to a reduction in disposable income of \$411 a year, around \$7.90 a week. For a person on median income the reduction in disposable income is only around \$5.90 a week.

The general population appear to understand this arithmetic implicitly if not explicitly. 67% of respondents considered that contributions of 12% or more are needed for most people. A strong majority (79%) of respondents in the 2009 Auspoll survey support or strongly support putting an extra 1% into super each time they received a wage increase or started a new job, up to a maximum of 3%.

What is being proposed would involve minimal employer burden. The adjustment to contribution rates would occur when employees are hired or receive a salary increase. Wage payments and superannuation payments need to be set or adjusted

at these times in any event. As well, given that around 90% of employees can be expected to go with the default, there would only be a limited number of employee elections to process. The calculations and administration of processing these elections by individual employees would also be very straightforward.

ASFA suggests that the appropriate legislative basis for implementing soft compulsion would be for the Commonwealth to make use of the corporations power to legislate a new standard condition of employment. Consequential amendments to the Commonwealth industrial relations legislation would also be required so that payment of increased superannuation contributions rather than wages was consistent with any applicable award or industrial agreement.

An alternative approach would be to build upon the Choice of Fund legislation to require employers to put in place soft compulsion arrangements for both new and existing employees. Again, amendments to industrial relations legislation would be needed to bring about consistency of increased salary sacrifice contributions with any industrial relations requirements.

There is also a strong case for more general industrial relations provisions which would permit or require employers to provide salary sacrifice arrangements into superannuation even if this led to the payment of cash wages below the amount specified in an award or agreement.

3.2 Compulsory superannuation coverage of the self employed

One argument that has been put forward against introducing compulsory superannuation contributions by the self employed is that there are self employed persons who consider the value of their business to be their retirement savings. However, this is only likely to apply to only a minority of the self employed as for most self employed their value of their business is largely dependent on their continued ability to be personally involved.

For those self employed who have a business which has a significant sale value independent of the proprietor's continued involvement, an option would be to provide an opt-out mechanism (by way of declaration on the individual's income tax return) that they have business assets that would qualify for the 'CGT rollover exemption for small business', that is, a saleable business or business premises.

There is substantial variation in the value of businesses owned by the self employed. For some self employed individuals the value of the business might be little more than the market value of a second-hand utility or truck and some tools of trade. For others, it might be the value of an ongoing business worth a million dollars or more.

Why the self employed should be covered by compulsory superannuation

The self employed make up a substantial proportion (over 10%) of the paid labour force in Australia. In 2006 there were around 830,000 individuals aged 25 to 64 whose principal source of income was from their own unincorporated business. The number of self employed is growing strongly with this figure up 6.5% on the 780,000 self employed in 2004.

On average the self employed are less likely to have superannuation than employees. Around 26% of the self employed have nil superannuation. In the case of self employed females, over 31% have no superannuation.

In addition to the 26% of the self employed (around 210,000 persons) who have no superannuation, a further 53% had less than \$40,000 in total. While 36% of wage and salary earners achieve a superannuation balance of more than \$100,000 in the run-up to retirement, only around 18% of the self employed do so.

Many of the self employed currently do not achieve significant savings either in the form of equity in their business, or retirement savings in superannuation or otherwise. Data from the Household, Income and Labour Dynamics in Australia (HILDA) Survey provide information on individuals of Age Pension Eligibility age in 2001 who were self employed five years earlier. The data indicate that 51% of this group were receiving some Age Pension, with 30% receiving the full Age Pension.

The Australian compulsory superannuation system has largely passed by the self employed. The great bulk of the self employed have little or no superannuation, and only a small minority make contributions on a regular basis. The evidence available indicates that many self employed individuals are not financially prepared for retirement given that those with little superannuation often have little other savings as well. A large proportion of the self employed currently go on to receive a full or part Age Pension from the government.

Australia is actually very unusual in terms of the current treatment of the self employed compared to most developed countries. Countries which have compulsory coverage of the self employed in earnings related pension or retirement savings arrangements include Canada, Finland, Iceland, Norway, Sweden, Austria, Czech Republic, Hungary, Korea, Portugal, Slovak

Republic, Switzerland, Turkey, and the United States. Countries which have special separate schemes for the self employed include Belgium, France, Germany, Greece, Italy, Luxembourg, Poland and Spain.

There is a strong level of community support for extending compulsory superannuation to the self employed. The September 2009 Auspoll survey indicates that 61% of those employed consider that the self employed should have to contribute to superannuation, with 50% of those who are self employed also supporting compulsion.

Recommendation 2: For self-employed people, ASFA recommends that:

- a compulsory contribution is gradually introduced for self employed people:
 - o starting at 1% of taxable income in 2010-11 and
 - o rising to 9% of taxable income in 2018-19.
- the contribution would be assessed as part of the tax return process with an additional amount collected from the individual (which could be rolled over into a complying superannuation fund) if the required contributions had not been made to a complying superannuation fund.

3.3 Abolish or reduce the SG threshold of \$450 a month in each job

For those working a series of low-paying jobs, the Henry Review's recommendation that SG continue not to apply where earnings in a given job are below \$450 per month will mean those affected will have little chance of achieving adequacy, even measured as a replacement ratio against their low income level.

The panel asserted that applying the SG from the first dollar of income may not be appropriate or cost-effective in many cases. Specific reference was made to the need to ensure that compliance costs to the employer are outweighed by the benefits to the employee.

ASFA considers that examination of actual employer compliance costs would support the complete abolition or substantial reduction in the threshold. For instance, for an employee earning \$300 in each month of a SG quarter, a 9% contribution would equate to \$81. The actual administrative cost to an employer of making a contribution would be far less than this. Administration costs for small employers will also be reduced when the Clearing House mechanism being implemented by Medicare comes into effect.

In fact, there are likely to be higher compliance costs for employers from there being a threshold. Paying super on every dollar of wages involves less monitoring and compliance effort than checking that wages paid are below \$450 in a calendar month, particularly if wages are paid on a weekly or fortnightly basis with varying numbers of payments between months depending on the cycle of payments. For this reason, and because they value their employees, a number of employers voluntarily pay super contributions on all wages paid.

Administration costs and net benefit are also likely to be positive for the beneficiaries of the superannuation contributions. It is often the case that an individual will have multiple jobs, particularly in industries such as office cleaning, hospitality or retail. As well, almost all adults in employment will have an existing superannuation account from a time when they earned more than \$450 a month. Again it is not unusual for a person to have spells of full-time or near full-time employment punctuated by periods of part-time or casual employment. This is particularly the case for women with family or other care responsibilities.

Removing or substantially reducing the earnings threshold for payment would be easy to implement, would involve lower compliance costs, and would deliver benefits primarily to low to middle income earners, particularly women given the incidence of women in part-time and casual work. There would be no impact on the take home pay of low to middle income earners. As well, a potential bias against the employment of those earning just above the threshold would be removed, leading to greater labour market efficiencies and productivity gains.

Recommendation 3: ASFA recommends that the \$450 a month threshold be substantially reduced or abolished

3.4 Tax support for superannuation relative to other forms of savings

The Henry Review of course has conducted a review of the tax treatment of saving and investment that goes far beyond the tax treatment of superannuation contributions and investment earnings. In the interim report the Panel indicated that it would be undertaking further work on the distributional implications of the retirement income system for its final report. More specifically, it was stated that there would be final recommendations in the December report maintaining tax assistance to superannuation but improving the fairness of concessions for contributions, including by broadening access to them and limiting generous salary sacrifice concessions.

Clearly there are a host of issues related to the taxation of the range of savings and the tax treatment of income from capital. Certain investments receive preferential tax treatment relative to other investments. Some forms of saving (principally through the family home) are exempt from capital gains tax. Capital gains tax concessions (relative to current income) also give rise to lower effective tax rates on negatively geared shares and property. On the other hand, interest income from forms of savings such as bank deposits are taxed relatively harshly, particularly when the impact of inflation on real returns is taken into account.

However, any actual or perceived deficiency in the tax treatment of other forms of savings does not mean that the tax concessions should be withdrawn or limited in regard to superannuation.

Previous attempts at tax preferred savings outside the superannuation system have not been particularly successful. For instance in the 1997-98 Budget the then government attempted to increase private savings through a savings rebate on net personal income from savings and investments (eg. unearned income less allowable deductions and net business income).

The saving rebate was fundamentally flawed in that savings were not required to be preserved or maintained for any period. As well, there was no requirement to change behaviour to attract the rebate:

- Sole traders making a profit automatically qualified.
- Public servants received it for continuing to be required to make after tax personal superannuation contributions.
- Shareholders receiving dividend income received it by retaining their shareholdings.
- People receiving bank interest received the rebate in respect of that interest.

The lack of preservation also meant that the rebate led to no significant or sustained increase in savings. Not surprisingly, the rebate lasted only a year or so before it was abandoned as a policy failure.

The macro economic consequences of a shift in voluntary savings from super to outside super also would be material. These non-super savings because of a lack of preservation and associated liquidity considerations generally would not have the long term horizon typically applied by superannuation funds. As a result, shifting tax concessions from super to other forms of saving would lead to less funds being available for longer term investments.

This is a real problem with most measures that attempt to encourage or support non-preserved savings. In effect, such measures simply reduce the tax paid by those with the most savings and this is not necessarily an equitable outcome. It certainly does not lead to more productive investments in the economy or improved retirement outcomes.

While some have argued that privileging superannuation as a savings vehicle has increased the reliance of banks on institutional funding, this ignores the reality of Australia's current account deficit. The current account deficit requires, essentially, Australia to borrow from overseas. As such, reducing tax incentives for superannuation would not be the "magic bullet" that provides banks with greater access to funds. The banks have already received considerable assistance in the provision by the government of the guarantee for accounts and for bank borrowings.

Australian superannuation funds have been significant investors in our economy and this includes providing high levels of liquidity to banks and the community in general. Indeed, the failure of banks to garner as much capital as they would like is a function of market forces. Australian banks should not forget that they are already the recipients of significant government largesse in the form of the bank guarantee.

Any actual or perceived deficiency in the tax treatment of other forms of savings does not mean that the tax concessions should be withdrawn or limited in regard to superannuation.

A shift in voluntary savings away from superannuation also would be likely to lead to an increased misallocation of resources within the Australian economy as some of the voluntary savings will be used on expanding the principal residence or on less diversified investments (eg negative geared property) than would occur through the super system.

Recommendation 4: ASFA recommends that superannuation continue to receive tax concessions relative to other forms of savings

3.5 Enhance equity in the superannuation system by retaining deductibility of contributions and not moving to a system solely based on tax rebates

Equity within the tax system is a fundamental characteristic of a sound and robust tax system. Equity also needs to be understood by the community so that the overall system has community support. An equitable system should also ensure that a particular group is not favoured excessively nor excluded from the available taxation support.

It is also noted that equity comes in many forms, including inter and intra generational, as well as over the lifetime of an individual. Receipt of the Age Pension also needs to be taken into account. Those who receive substantial tax concessions for superannuation contributions will receive little or no Age Pension once they are retired.

Such a whole of life approach was adopted by Dr George Rothman of the Retirement and Intergenerational Modelling and Analysis Unit in the Department of the Treasury in his July 2009 paper, *Assessing the Equity of Australia's Retirement Income System*.

That paper demonstrates that the cost to government of tax concessions for superannuation and Age Pension expenditures is remarkably steady from income deciles 1 to 10. The author concludes that using this more comprehensive approach, the retirement income system after the 2009 Budget is found to be more equitable, both vertically and by gender, than many would have expected.

Accordingly, it can be argued that the current system of tax concessions and Age Pension provision is not so broken that it needs fundamental changes. That said, tax concessions for superannuation do not provide significant assistance for low income earners. Another July 2009 research paper by David Tellis of Treasury indicates that some 1.6 million individuals currently receive no tax concession on their supposedly concessional superannuation contributions. ASFA's recommendations in regard to the lower paid, set out below, address this shortcoming.

Saving for retirement through superannuation raises some particularly difficult issues as such saving is not conducted for the short term. Indeed it is spread over many years and decades through which the financial conditions of individuals (and hence their capacity to voluntarily save for retirement) can vary considerably.

Additional diversity also needs to be recognised in the range of superannuation arrangements present within the Australian community. Some of the variety includes:

- Defined benefit and defined contribution schemes – For example, DB schemes use notional contributions for the contribution caps whereas DC schemes use actual contributions which can raise inequities
- Special schemes such as for the military, police etc – In these cases, the contribution rates are often higher than normal to allow for the special circumstances and earlier retirement ages
- Taxed and untaxed benefits – these benefits are treated differently and inequities arise
- The treatment of untaxed benefits – Many Commonwealth public servants are not subject to the contribution caps whereas State public servants are subject to these caps, even when untaxed benefits are paid

In brief, there is great diversity in the superannuation arrangements for Australian workers which cannot equitably be treated by including employer and other deductible contributions in the taxable income of individuals and only allowing tax rebates in relatively small amounts. ASFA is aware that a number of commentators have suggested such a change, and that there are indications that the Henry Review looked at such an option.

However, abolition of tax deductibility of employer contributions would involve a fundamental change to the tax treatment of superannuation. It would be particularly problematic for members of defined benefit superannuation schemes, with a significant minority of employees in Commonwealth and State public sector schemes, and some private sector schemes (or Divisions of such schemes) such as Unisuper or the Qantas Superannuation Fund.

Making all employer contributions taxable as though received by the employee would require a return to the calculation of notional superannuation contributions. All the difficulties and more of the superannuation surcharge would return, with every member of such funds with actual or notional tax debts accruing relating to their superannuation contributions.

Many members of defined benefit schemes could face massive tax bills on notional contributions that they never receive a benefit from, or at least not for many years. As with the surcharge, notional contributions are merely notional and average and do not reflect what will be the actual benefit in an individual case.

As well, for such a proposal to be implemented by taxing contributions to funds by using PAYG tax schedules for employees it would be necessary for employees to have only one job and with no other income apart from their job. Employers do not know what the marginal tax rates of their employees are. All that they know is what the amounts are being paid in the current pay period, and the details of any declarations made by the employees. Many employees in second jobs are subject to relatively high withholding rates even they eventually will be subject to much lower tax rates on the income when they are assessed after lodging their tax return.

Equally, the ATO would need to know what income and contributions were on a real time basis in order to put in place appropriate withholding taxes and payments of co-contributions or tax offsets. There would also need to be extensive reworking of amounts of tax withheld in regard to superannuation contributions on final assessment each year.

This would be a completely unworkable system in practical terms, particularly when many employees change jobs, funds and addresses during a year and some take superannuation benefits funded out of current year contributions. Like the superannuation surcharge, the ATO would have to continually chase the final destination of contributions in order to get the correct tax and co-contribution payments. The task would be much harder than with the superannuation surcharge as all persons with superannuation would be affected, not just higher income earners.

A further difficulty with making employer contributions assessable at the employee level is that it would mean that employees would in effect have their taxable income increased by 9% (the amount of the SG). This would lead to many individuals facing a higher marginal tax rate on their non-employment income and also on any employment related income from overtime or bonuses.

A rebate system for tax preferred contributions would also in effect cap the concessional contributions. A model for tax rebates that has been canvassed in public debate by one commentator would in effect set the cap on tax preferred contributions at either \$25,000 or \$12,000 a year (depending on the rate of contribution and maximum amount of co-contribution in the two options put forward).

There would also be a range of equity issues involved in making a tax rebate for contributions work for the self employed and for those with a marginal attachment to the paid labour force. This is because once eligibility for receipt of such rebate was established it would deliver relatively generous benefits for those with a low current year taxable income. It would also create a powerful disincentive for individuals to receive wages income in excess of the amount which generated the maximum rebate as the marginal tax rate on that part of their remuneration which is superannuation would increase substantially.

On the other hand, a person on a relatively low income who received a redundancy payment or other one-off payment in any given year would end up missing out on any tax assistance in regard to their superannuation in that year.

Recent opinion polling commissioned by ASFA indicates that while 44% of those aged 25 to 69 in employment consider that the taxation treatment of superannuation is not fair, the great bulk of respondents gave unprompted reasons for this which related to too much tax being paid, rather than higher income earners being unduly advantaged. The most commonly stated reasons for the unfairness of the current taxation arrangements were: taxed multiple times; superannuation should be tax free; too much tax on superannuation; paid tax all our lives; current system does not support the goal of self sufficiency; and little incentive to contribute. Only 4% of respondents indicate that favouring high income earners was a source of unfairness in the taxation of superannuation contributions.

Accordingly, relying only on a tax rebate system for superannuation contributions apart from the practical and other difficulties outlined above would fail the community tests for fairness for superannuation. It would involve more layers of taxation, higher taxes and administrative complexity.

However, there is a role for tax rebates working in conjunction with the current concessional tax treatment of superannuation contributions. ASFA addressed the tax inequity issue for lower income earners in previous submissions to the Henry Review, and we reiterate here our previous recommendations:

- Rebate (via the co-contributions system) the 15% contributions tax on SG and any other pre-tax contributions for low income earners – say below Average Weekly Earnings (currently around \$58,000 p.a.). This figure should be indexed.
- Expand co-contributions to middle income earners – for example lift lower co-contribution limit from \$30,342 to a higher income eg. \$50,000 so that it phases out at \$80,000 (limits continue to be indexed).

Recommendation 5: The current superannuation co-contribution should be enhanced to assist the equity of tax treatment of low income earners, with current tax deductibility of superannuation contributions being maintained

3.6 Maintain the current transitional caps for superannuation contributions

The annual caps for concessional contributions, as imposed in the May 2009 Budget, were set at relatively modest levels which impact on both middle and higher income Australians. In particular, many Australians now aged 40 or over have not had the opportunity to receive superannuation contributions throughout their working career. It is not fair that an opportunity to catch-up on contributions be unduly restricted in their later years, when some of them will have the opportunity to make more substantial savings for their retirement years.

Equitable taxation concessions should enable all Australians to contribute to their preserved superannuation benefits (i.e. their future retirement income) in a manner that is fair across all situations whilst also providing incentives to encourage the desired behaviour. The best way to proceed may be enhancement or retention of the current higher transitional caps for those aged 50 and over.

Particular caution should be applied to point estimates of superannuation contributions and member incomes. These estimates often are very dependent on the particular sample survey, and may involve not many cases in the sample given that the incidence of high superannuation balances and/or relatively high superannuation contributions are quite low in the community. Unfortunately there is not a large proportion of the Australian population with large wealth and/or incomes.

There would also be important practical and equity issues in further reductions in the caps on concessional and non-concessional contributions. The caps announced in the May 2009 Budget already are coming very close, or have gone below, the annual employer contributions that are required for some employees due to the Superannuation Guarantee or the operation of other legislative or industrial relations provisions. Further tightening of the caps would also raise considerable equity and practical issues in regard to the notional contributions involved in defined benefit schemes. The array of problems and inequities that were associated with the Superannuation Surcharge would resurface. Fundamentally, the level of actual or notional contributions in any given year has little to do with whether an individual is receiving equitable tax treatment.

The reduction in caps already has had a number of detrimental consequences. It has:

- damaged the ability for under-funded members to make catch-up contributions in the years before they retire;
- thrown into question the strategy of many employers to contribute more than 9% to their employees through their corporate funds; and
- precluded many members of corporate, public sector and defined benefit funds from making any salary sacrifice contributions.

The recent (and any further) reduction also significantly increases the likelihood of unintended breaches of the cap, due to the complexity of the application of the caps:

- o in salary sacrifice decisions by members of defined benefit funds, or where employers subsidise fund costs;
- o where trustees decide to distribute surplus to members.

Members entitled to defined benefits or employer subsidies for costs have their concessional contributions calculated on “notional” employer contribution rates. Distributions of surplus also count as notional concessional contributions.

Trustee decisions about distribution of surplus require a careful analysis of members’ contribution patterns in order to avoid breaches of the caps by members who have made salary sacrifice decisions with no expectation of receiving a surplus distribution – this significantly increases the administration costs to the fund of determining and implementing what should be a simple process of returning surplus to members.

Despite the seeming simplicity of the caps, notional concessional contributions are **not** easy for members to understand. Miscalculations are inevitable. Preliminary advice from the Australian Taxation Office indicates that a substantial number of taxpayers have breached the caps, clearly inadvertently given the tax consequences. Under the caps applying before the last Budget, only a small number of members were potentially affected and the complexities were manageable. The reduction of the caps increases the number of affected members and, importantly, the new caps are likely to affect members whose income does not attract the top marginal tax rate.

Level of the caps

ASFA considers that the caps at the previous levels (\$50,000 and \$100,000) addressed the equity issue in that they were sufficient in limiting the quantum of assets a wealthy individual could build up in the tax-advantaged superannuation system. As such ASFA recommended in our previous submission that the contribution caps be retained, with the proviso that individuals such as those with broken work patterns, part-time workers, immigrants and expatriates could apply for a higher cap.

At the previous level, the caps struck a balance as follows:

- they went a long way towards limiting excessive contributions by high income earners;
- they allowed those in “catch-up mode” in their later years to contribute larger amounts towards their retirement, and
- they did not hamper many of the more generous contribution structures in defined benefit, corporate and public sector funds.

The reduction of the caps, particularly for the over 50s, has already significantly reduced the ability of under-funded members to catch-up in later years. Middle income earners typically have limited capacity to save until they reach this age bracket (when their mortgage is paid and children are post-school age).

ASFA notes that the reduction of the caps was a budget measure. ASFA accepts that the global financial crisis has necessitated a number of short-term measures to raise Government revenue (such as the temporary reduction in the co-contributions). A reduction in the caps as a temporary measure might be justified on this basis.

However, for adequacy of retirement incomes in the long term, ASFA recommends that the previous caps be reintroduced in the 2010-11 Budget. At the very least, additional flexibility in the caps for people over age 50 is required to permit adequate levels of catch-up funding.

Recommendation 6: ASFA recommends that the contribution caps for concessional contributions revert to \$50,000 for those aged under 50 and to \$100,000 for those aged 50 and over, or that at the very least the current transitional \$50,000 a year cap for those aged 50 and over be maintained indefinitely

3.7 Maintain the preservation age for receiving benefits at the current maximum of age 60

ASFA was concerned by the proposal in the Interim Henry Report to increase the preservation age and we welcomed the announcement by Prime Minister Rudd that the super preservation age will not be changing.

Currently, the preservation age for those born after 30 June 1964 is 60. Increasing this age would disadvantage a number of groups:

- people who work in physically demanding jobs who may be physically unable to continue working in the same jobs after the age of 60
 - requiring such people to retrain and obtain a different type of work is not always practical, particularly given the difficulties older people have in getting a job
- people who need to leave work due to ill health
 - this is one of the major reasons given for early retirement
- people who need to leave work to care for a family member
 - this is another major reason cited for early retirement
 - this issue mainly affects women who are more commonly carers.

The income alternatives for the above people if they are aged less than age pension age are mainly:

- superannuation
- disability benefits
- unemployment benefits.

Currently some 400,000 Australians aged 55 to 64 are drawing on superannuation. The great bulk of these recipients are either not in the labour force or unemployed. Increasing the preservation age to 65 or 67 would place an enormous demand on disability and unemployment benefits provided by the Commonwealth.

Delaying access to superannuation for a number of years would therefore only increase reliance on other government benefits for these groups. This both increases the cost to the government and is also potentially humiliating for those who have been hard-working, productive citizens all their working lives.

In the Auspoll survey conducted in September 2009 85% of respondents opposed an increase in the preservation age to age 67. As well, feedback from funds and advisers indicates that uncertainty about possible changes in the preservation age is a factor inhibiting additional voluntary contributions.

Recommendation 7: ASFA recommends that there be no increase in the preservation age above age 60 and that the Government indicate that there is no intention to increase it at any time in the future

3.8 All Total and Permanent Disablement Benefits paid in income stream form to be tax free regardless of the age of the recipient

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

3.9 Superannuation Clearing House & Lost Members Framework

ASFA is on record as supporting the announcement by the Government that Medicare will provide a free of charge clearing house for superannuation contributions made by small employers.

ASFA considers that this initiative should be built upon so as to provide a coherent strategy to address the main operational and process-related issues that create additional costs in the superannuation industry. Solving these issues will be a major step towards reducing the fees charged to superannuation members.

There is clearly a desire within the superannuation sector to improve industry efficiency in the collection of contributions and the validation of data.

ASFA is committed to leading the industry in the development of a solution capable of addressing the issues experienced by all of our stakeholders. It is our view that this solution should encapsulate all superannuation users, including fund members, large and small employers and large and small superannuation funds.

After extensive discussions with industry players and service providers, ASFA is proposing a project that would ultimately lead to a comprehensive solution being delivered.

ASFA has identified a set of key outcomes or goals for the project. These are the key issues that need to be solved in order to increase processing efficiencies, improve service to employers and fund members, and reduce administration fees charged to fund members:

These outcomes are:

1. To significantly increase the volume of superannuation contributions and related information delivered electronically by employers;
2. To make the delivery of SG "choice" contributions information and money easier for all employers (this includes reducing the number of rejected contributions);
3. A reduction in the number of multiple accounts;
4. A reduction in the volume of accounts that become "lost";
5. To make rollovers between funds easier for members; and
6. To improve the quality of data and to reduce the number of rejected contributions.

Budget and Time Frame

The initial scoping phase – investigation and recommendation of a structure and (where relevant) technology provider or providers is expected to cost \$300,000. This scoping phase would be completed within three months of receiving funding.

Recommendation 9: ASFA recommends that \$300,000 in funding be provided by the government to for a project to be run by the superannuation sector aimed at increasing the efficiency with which superannuation contributions and rollovers are processed

3.10 Providing permanent capital gains tax relief for superannuation funds that merge

Many super funds have been looking at merging with other funds to provide the best possible services and return to their members. Under current laws, capital gains generally are crystallised when funds merge or when they transfer investments into a wholesale investment vehicle like a Pooled Superannuation Trust (PST).

The government has provided temporary CGT relief following the Global Financial Crisis (GFC) when most funds accrued capital losses. The relief provides is primarily in regard to the rollover of capital losses. In ASFA's view this relief should be made permanent and extended to the rollover of all capital gains.

Trustees must be able to act in the best interest of fund members by achieving the most efficient way of delivering investment returns. Allowing funds to merge without crystallising capital gains would remove a current disincentive to fund mergers and would lead to greater efficiency in fund operations.

Recommendation 10: ASFA recommends that superannuation funds be provided with permanent relief for the taxation of capital gains when assets are rolled over between superannuation funds and/or between Pooled Superannuation Trusts (PSTs) on merger of two superannuation funds

3.11 Maintaining an appropriate Reduced Input Tax Credit Rate for superannuation

Following a recommendation by the Board of Taxation, the Government is currently undertaking a review of the financial supplies provisions with a view to reducing their complexity and introducing more principled rules, while maintaining existing policy. Part of that review is considering the appropriateness of the Reduced Input Tax Credit (RITC) rate for financial supplies, which is currently set at 75%.

Any reduction in the 75% RITC rate applying to certain services purchased by superannuation funds would result in higher costs for superannuation funds. These higher costs would be required to be met from members' accounts within funds. While many fund trustees outsource their administration and investment management, others engage their own staff to provide the services within the trustee corporate entity, and yet others have the trustee engage the staff directly in its capacity as trustee of the superannuation fund. Equally some funds outsource only some services while in-sourcing others. It is necessary to have an RITC set at an appropriate level so that decisions on whether to conduct an activity in-house or to outsource it are not distorted by GST tax considerations.

Two types of services typically outsourced by a superannuation fund are administration and fund management services. ASFA has received independent advice that demonstrates that, for both a superannuation fund administrator and a fund manager, the rate of 75% is an appropriate RITC rate for eligible acquisitions by superannuation funds.

Recommendation 11: ASFA recommends that superannuation funds continue to receive the benefit of a 75% Reduced Input Tax Credit for the GST on eligible purchases by superannuation funds