ASFA Policy and Industry Practice

Pre-Budget Submission for the 2011-12 Budget

ASFA Submission

February 2011

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 and, in particular, are not dependant on any new tax or revenue source to be introduced.

This year's Pre-Budget Submission from ASFA takes into account the Government's announced response in May 2010 to the final report of the Review into Australia's Future Tax System (the Henry Review). Given that a tax forum is to be organised later this year, the Budget provides an opportunity for the Government to both endorse and clarify a number of measures it will be legislating and/or taking to the tax forum.

In particular, ASFA considers it crucial that the announced phased increase in the Superannuation Guarantee (SG) from 9% to 12%, together with the tax rebate for superannuation contributions made on behalf of low income earners, be legislated as soon as possible. The passage of such legislation would ensure a substantial improvement in the adequacy of future retirement incomes, and would also bolster confidence in the superannuation system.

The submission also sets out a number of measures that would significantly improve the financial circumstances of women, particularly their standard of living in retirement.

Recommendation 1: The increase in the compulsory rate of superannuation contributions from 9% to 12% should be further endorsed in the Budget. A bringing forward of the increases would further assist working Australians.

Recommendation 2: The Government continue to reject the Henry Review proposals in regard to the taxation of superannuation contributions and fund earnings.

Recommendation 3: For self-employed people, ASFA recommends that:

- **a compulsory contribution is gradually introduced for self employed people:**
  - **starting at 1% of taxable income in 2012-13; and**
  - **rising gradually over time to 9% of taxable income in 2020-21.**
- **the contribution amount 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.**
- **Similar to the arrangements for SG contributions, an indexed maximum earnings base ($168,880 in 2010-11) would apply.**

Recommendation 4: ASFA recommends that the $450 a month earnings threshold for receiving Superannuation Guarantee contributions be substantially reduced or abolished.

Recommendation 5: ASFA recommends that the Government introduce the payment of superannuation contributions on paid parental leave from 1 July 2011.

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, either for those with superannuation savings of less than $500,000, or more generally.

Recommendation 7: ASFA recommends that superannuation funds be provided with 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. This relief should be at least until 30 June 2013 or preferably be permanent.

Recommendation 8: ASFA recommends that if further drawdown relief is to be provided for holders of account based income streams, this relief be announced as soon as possible and no later than by Budget night 2011.

Recommendation 9: ASFA recommends that the current legislation and regulatory practices which restrict product development in the retirement space be amended or changed as follows:

- **Abolish Income Ruling IT 2480**
- **Modify or repeal SIS regulation 1.06(2)**
- **There be co-operation between the Regulators in terms of approving new retirement products. Currently product providers must deal separately with the ATO, APRA, ASIC, and DFACS.**

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 over 90% of the approximately 12 million Australians with superannuation as members. ASFA members manage or advise on the bulk of the $1.3 trillion in superannuation assets as at September 2010. 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 equitable. We also acknowledge the fiscal challenges faced by the Government as a result of the flood damage in a number of States. Accordingly, we have given careful consideration to the costs of our proposals. We have also undertaken analysis of the groups who would particularly benefit from adoption of the measures.

1. INTRODUCTION

The May 2010 response to the final report of the Review Panel for Australia's Future Taxation System (the Henry Review) introduced a number of superannuation measures. These, through a combination of compulsory and voluntary superannuation contributions, have the potential to enable a substantial proportion of the population to achieve an adequate and dignified existence once they have left the paid workforce.

At the time of the finalisation of this submission (early February 2010), the Government had not yet introduced legislation for any of these measures. As well, the foreshadowed increase in the SG was proposed to be increased prospectively and to be phased in over a number of years.

The Government has announced its intention to conduct a Tax Forum in the middle of 2011. In ASFA's view, the superannuation measures announced last year should not form part of the agenda for the Tax Forum. The measures are both affordable and supported by the great bulk of the community.

In terms of affordability, the impact on the Forward Estimates from the various proposed superannuation measures is generally not until 2013-14 when, on the basis of current projections, the overall budgetary situation will be stronger. As well, the phased increase in the SG to 12%, one of the most important measures in regard to improving adequacy of retirement incomes, has a projected budgetary cost of only $240 million in 2013-14. The other measures will also form only a small part of government net expenditures in that and later years.

In particular, ASFA does not consider the superannuation measures should be linked to the Minerals Resource Rent Tax (MRRT) that the Government intends to apply. The cost to tax revenue from increasing the rate of the SG is relatively small in terms of the overall Commonwealth Budget.

In ASFA's view, any winding-back of the proposed increase in the SG and in the new tax concessions for low income earners and older Australians with relatively low superannuation balances, would be very short sighted. 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. 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.

As well, an unintended consequence of linking the two might be to make the MRRT package even more complex than it already is. That proposal needs to be as simple and understandable to the public as possible for it to gain support. As well, linking the SG increase to the passage of the MRRT may inadvertently give the impression that the Government is not truly committed to improving standards of living in retirement. Confidence in superannuation would be eroded by a perception that superannuation measures were a short-term tradeable commodity in the political process.

For these reasons, developing a strategic vision is particularly important. This submission addresses what should be included 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. The 2011 Budget provides an opportunity for such a long-term vision to be set.

Setting a retirement income goal

ASFA believes 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 $23,000 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. For most individuals, contributions of at least 12% of earnings are needed to deliver appropriate outcomes in retirement.

Improving economic and financial outcomes for women

Currently women, on average, achieve superannuation savings which are considerably lower than those achieved by men. The Budget provides an opportunity for the Government to introduce measures designed to reduce these inequalities in outcome. The Government has already introduced paid parental leave. This will assist many women but removing the $450 a month wages threshold and introducing payment of SG on parental leave payments would provide considerable further assistance to women and would reduce gender inequalities.

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, appropriate levels of support should be provided for individuals across the income range.

The proposed tax rebate for low income earners would assist in meeting both these goals. As well, maintaining a higher concessional contribution cap for those aged 50 and over with relatively low superannuation balances would enhance the equity of the system. Fixed, annual limits on concessionally taxed contributions can be too inflexible and inequitable. Annual limits, but with some flexibility for designated groups seeking to catch-up on their retirement savings, is the preferred approach.

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 2011-12 Budget

Recommendation 1: The increase in the compulsory rate of superannuation contributions from 9% to 12% should be further endorsed in the Budget. A bringing forward of the increases would further assist working Australians.

The proposed increase in the rate of the SG is justified on the basis of the improvements in retirement outcomes that it will deliver. Pursuit of this measure is also important to maintain the confidence of Australians in future superannuation arrangements.

In this context, both superannuation and the prospective adequacy of retirement incomes have become "top of mind" topics for most Australians. This is particularly so following the impact of the Global Financial Crisis (GFC) on retirement savings and following the Henry and Cooper Reviews which both focused on such issues.

The extent of retirement income adequacy concerns in the population was explored in October 2010 when ASFA commissioned research into attitudes to superannuation and superannuation related policy issues.

One question asked how "having enough money to retire with" compared to a number of other financial concerns that might be faced by respondents. Each of the concerns presented was ranked by respondents on a 1 to 7 scale of importance. A value of 1 given to a matter indicated that it was not much of a concern, while a ranking of 7 indicated that it was very much a concern.

Having enough money to retire with was identified on average as the main financial concern of respondents (with a score of 5.1 out of 7), followed closely by paying for everyday expenses (5.0), and then paying the mortgage (4.5). Healthcare expenses (4.1) and job loss (3.8) are further down the list, with the GFC (2.8) and education expenses (2.7) even less of a concern.

As shown by Table 1, an increase in the SG to 12% will deliver substantially more adequate outcomes for individuals and households. Outcomes for low income individuals would be further enhanced by the Government's proposed tax rebate for contributions made on behalf of low income earners.

TABLE 1: Lump sum retirement benefits after 30 years in a taxed fund

Tax treatment and contribution level	Wage of $30,000	Wage of $50,000	Wage of $100,000
9% contributions and investment earnings taxed at current rates	$110,000	$183,000	$366,000
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 for a couple (assumes receipt of part Age Pension).	$510,000	$510,000	$510,000
Lump sum needed to support comfortable lifestyle for a single person (assumes receipt of part Age Pension).	$430,000	$430,000	$430,000

All figures in today's dollars (using 3.75% AWE as a deflator), investment earning rate of 7% assumed. Annual expenditures needed for a comfortable lifestyle are as at September 2010 $39,302 for a single, $53,729 for a couple.
The lump sums needed for a modest lifestyle are relatively modest, being $50,000 for a single and $35,000 for a couple as the required expenditures of $21,132 for a single and $30,557 are mostly met by the Age pension of $17,165 for a single and $25,878 for a couple (with a pension supplement also available).

Recommendation 2: The Government continue to reject the Henry Review proposals in regard to the taxation of superannuation contributions and fund earnings.

The Government proposals in regard to an increase in the SG to 12% and the introduction of a tax rebate to increase the superannuation savings of low income earnings have been generally well received. They involve change, but to the benefit of superannuation fund members.

In contrast, the Henry Review recommendations on superannuation would have adverse impacts for most fund members and would also lead to lower net tax revenues to government for many decades.

The impact of the Henry recommendations compared to the Government's proposals

Analysis undertaken by the ASFA Research Centre indicates that superior outcomes for individuals and for tax revenue would flow from adoption of the package of an increase in the SG and the introduction of a tax rebate in regard to contributions made on behalf of low income earners announced by the Government in its response to the Henry Report.

In particular, the low income superannuation contributions rebate proposed by the Government would lead to substantially higher net contributions flowing to the benefit of lower income earners compared to the Henry proposals.

More generally, across a range of income levels, the Government proposals for increasing the SG to 12% and for a low income contributions tax rebate generally deliver both higher take-home pay and higher retirement savings than the Henry Review proposals.

For instance, the differences are as follows:

- for an average wage earner on $60,000 a year currently receiving a 9% superannuation contribution, the ASFA analysis indicates the Government proposed measures would lead to take-home pay $65 a year higher than the Henry proposals on personal tax and superannuation contributions, with net superannuation contributions also higher by $558 a year.
- For a teacher in a public sector defined benefit scheme on around average earnings ($60,000 per year), take-home would be around $2,020 a year higher under the Government measures than under the Henry proposals, with no reduction in the superannuation entitlement.
- For a low income earner on $35,000 a year, the Henry proposals would result in higher take- home pay due to a lower personal income tax rate and 3% of future remuneration increases being paid as cash rather than superannuation contributions. However, this would be largely offset by lower superannuation contributions and no receipt of the proposed low income superannuation contributions tax offset.
- For an upper income earner on $180,000 a year, the Henry proposals would result in take- home pay down by $7,944 a year, and net superannuation contributions down by $1,674 a year.

The Henry Review recommendations on the tax of fund earnings

Along with changes to the taxation of contributions, the Henry Review recommended substantial changes to taxation of fund earnings in Recommendation 19 of the Report:

- The rate of tax on superannuation fund earnings should be halved to 7.5%.
- Superannuation funds should retain their access to imputation credits.
- The 7.5% tax should also apply to capital gains (without a discount) and the earnings from assets supporting superannuation income streams.

There are some superficial attractions to this recommendation:

- A lower tax rate on investment earnings would assist individuals in accumulating retirement savings. The impact of compound interest is assisted by there being a higher after-tax earnings rate. The Henry Report includes some numbers based on such a higher earnings rate.
- Tax reporting and administration of funds would be simpler with only one set of unit prices or crediting rates for both accumulation and pension products with the same investment choice (although substantial systems changes would be needed to transition from the existing approach).
- The transition from accumulation to pension phase would be simpler with a level playing field between all types of funds. Currently some funds find it difficult or impossible to move capital gains to the pension phase from the accumulation phase.

However, for most individuals this new tax during the retirement phase would largely negate the benefits from a lower tax rate during the accumulation stage. The projected benefits to individuals that are set out in the Henry Report relate to the accumulation stage. The measure would also remove the only remaining incentive to take an income stream in retirement rather than continue with an accumulation account with no drawdown requirements.

More specifically:

- For a wage earner on $50,000 a year in the workforce for 35 years, halving the investment tax rate would boost the eventual accumulation balance from $246,000 to $258,000. If they seek a target income (including Age Pension) of $30,000, this lump sum would be exhausted at age 90. This is the same age at which the lump sum would be exhausted with a 15% tax rate during accumulation and zero rate during drawdown, but the uniform tax rate would lead to the lump sum being exhausted around 6 months later.

- For someone starting with $200,000, on a salary of $100,000 and with a further 20 years of accumulation, they would have their accumulation boosted from $603,000 to $626,000. However, they would be disadvantaged by a uniform investment earning tax rate. Assuming a $50,000 income in retirement, the lump sum would run out at age 84 rather than 85. Amongst other things, the Age Pension means test impacts more on those with higher accumulations.
- For individuals who currently postpone the realisation of capital gains until the retirement phase, the impact of the Henry Review proposals would be adverse.

Community concern about stability of arrangements for super

A barrier to the community contributing additional amounts to saving for retirement is the perception that more changes will be made to tax and other relevant provisions. Less than 2% of respondents in October 2010 considered that when they retire superannuation tax arrangements will be the same as today.

With 65% of respondents considering that the tax arrangements will be quite different or very different to today, there is a major behavioural finance barrier to getting the bulk of Australians more engaged with their superannuation. It is very easy for an individual to opt out from a decision, such as saving more, if there are serious concerns that there will be adverse future changes to the tax treatment of superannuation. Achieving widespread behavioural change will require confidence in policy permanence or, at the very least, confidence that adverse changes will not be made in the future that will impact on them individually.

Government support in the Budget for stability in the treatment of superannuation, in this sense of there not being decisions to make future adverse changes, would play an important role in bolstering confidence in superannuation and in supporting increased retirement savings by individuals.

Recommendation 3: For self-employed people, ASFA recommends that:

- **a compulsory contribution is gradually introduced for self employed people:**
  - **starting at 1% of taxable income in 2012-13; and**
  - **rising gradually over time to 9% of taxable income in 2020-21.**
- **the contribution amount 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.**
- **Similar to the arrangements for SG contributions, an indexed maximum earnings base ($168,880 in 2010-11) would apply.**

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 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 provides information on individuals of Age Pension Eligibility age in 2001 who were self employed five years earlier. The data indicates 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.

In Australia there has been a long-term trend to greater use of contractors, particularly in some sectors of the economy. As well, some employers (including those in the building industry) have attempted to avoid superannuation and other obligations through the use of contractors. An extension of the compulsory superannuation system to the self employed would stop what is currently a significant source of leakage from retirement savings in Australia.

Consistent with the arrangements that apply to employees in regard to the cap which applies to compulsory contributions, there should be an equivalent cap applying to the taxable earnings of the self employed. The maximum quarterly earnings base for employees was $42,220 in 2010-11. This would translate into a taxable income cap for compulsory contributions by the self employed of $168,880 a year.

Measures which would particularly assist women

Recommendation 4: ASFA recommends that the $450 a month earnings threshold for receiving Superannuation Guarantee contributions be substantially reduced or abolished

ASFA considers the principle that "work of equal value should attract equal remuneration" implies that the $450 a month threshold of earnings from any given job for receiving SG contributions should be abolished.

Superannuation contributions form an important part of overall remuneration. The SG generally requires contributions from employers of 9% of ordinary term earnings, as defined in the relevant legislation, to be made for the benefit of eligible employees.

However, the legislation currently does not require contributions to be made on behalf of employees who receive less than $450 a month from an employer. While some industrial awards provide for such payments, the lack of any general provision means that a substantial number of part-time employees do not receive the benefit of compulsory superannuation contributions. As a result, they receive remuneration which is around 9% less than employees who are doing identical or similar work but who are paid more than $450 a month by an employer.

In a number of sectors in the economy there are many casual employees. Many of these employees are female. For instance, statistics published by the Australian Bureau of Statistics (Employee Earnings and Hours, Cat. No. 6306.0) indicate that 17.5% of female community and personal service workers have weekly cash earnings of less than $200 a week. The comparable percentage for males is 12.8%. This compares to figures for the overall labour force of 11.5% for all female workers and 6.5% for males.

In total, around 130,000 males and 200,000 females in the workforce would benefit from removal of the $450 a month threshold for superannuation contributions. Many females are currently doubly disadvantaged in regard to superannuation contributions. What can be relatively low average earnings leads to lower superannuation contributions for those with earnings in excess of $450 a month. With many females in part-time work there can be a significant number of females who miss out altogether on contributions.

The latest available figures (which relate to 2006) for superannuation balances by employment status indicate that 68% of part-time workers had total superannuation balances of $40,000 or less.

Both on gender equity and wider equity grounds ASFA considers that compulsory superannuation should cover those earning less than $450 a month.

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 have also been reduced by the Clearing House mechanism administered by Medicare.

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, and particularly to 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 5: ASFA recommends that the Government introduce the payment of superannuation contributions on paid parental leave from 1 July 2011

The Government has introduced a major social advance with the provision of paid parental leave with effect from 1 January 2011. However, the parental leave provisions do not provide for any superannuation contributions at this point for the payments made to individuals.

This issue has already been subject of considerable analysis and consideration. Specifically, the Productivity Commission in its inquiry into paid parental leave found that there is a prima facie case that employers should fund superannuation contributions during the paid parental and paternity leave period, with:

- superannuation entitlements calculated on the pre-birth (or pre-adoption) wage of the employee who is taking the leave, or at the federal minimum wage, whichever is the smaller
- mandated superannuation contributions under the scheme should be limited to the statutory rate (currently 9%), but with no bar to privately negotiated higher rates.

The Government has indicated an intention to review the operation of the paid parental leave scheme by 2013, including the possible payment of superannuation contributions in regard to such payments.

ASFA considers that on equity grounds the review of the superannuation arrangements should be brought forward. The parental leave provisions are projected to benefit some 148,000 families a year at a cost of around $260 million. Superannuation contributions at the rate of 9% would cost only an additional $24 million a year, with the net cost of this reduced by the 15% tax on contributions. It has been estimated that an additional three months superannuation contribution to a balanced portfolio would add over $3,000 to the final account balance (based on standard ASIC assumptions about investment earnings on a balanced fund for a 30- year-old woman earning $50,000 pa on 12 months unpaid parental leave).

Such a measure is both equitable and affordable.

A number of employers have already introduced superannuation payments relating to parental leave. National Australia Bank (NAB) recently joined Westpac and St George Bank in paying employees superannuation on unpaid parental leave. The decision of these employers to pay superannuation contributions on the paid parental leave will benefit working parents and working women in particular.

The more general extension of the payment of superannuation contributions to all paid parental leave would be affordable to the budget. It would benefit 148,000 families and in particular would help redress the current substantial gap between the superannuation savings of men and women caused by, amongst other things, women being absent from the paid workforce because of family responsibilities. In 2007, the median superannuation balance for men aged 35 to 44 was $41,000 compared to only $22,600 for women.

ASFA considers that the case for superannuation contributions on paid parental leave has already been established and the introduction of such payments should not be dependant on a review of the arrangements in 2013.

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, either for those with superannuation savings of less than $500,000, or more generally.

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. Australian Bureau of Statistics (ABS) figures indicate that in 2007 only around 39% of those aged 45 to 54 had superannuation balances over $100,000.

It is not fair that an opportunity to catch-up on contributions be unduly restricted when a significant proportion of individuals will have a greater opportunity to make more substantial savings for their retirement years. In particular, many women will not have a chance to make substantial contributions until they have resumed full-time work after a period when they had only part-time work or were not involved in paid work due to family responsibilities.

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 while 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.

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 SG 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 Government's announcement to allow those aged 50 and over to have concessional contributions of up to $50,000 a year, provided they have a superannuation balance of less than $500,000 in total, goes some way to addressing the problems of what would be a very strict regime of a general cap on concessional contributions from 2012. At the very least, ASFA considers that the Government should recommit to this proposal in the May 2011 Budget. Preferably it should go further and endorse higher concessional contribution caps.

The reduction in caps has already 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 current and prospective contribution caps also significantly increase the likelihood of unintended breaches of the cap, due to the complexity of the application of the caps:

- in salary sacrifice decisions by members of defined benefit funds, or where employers subsidise fund costs;
- 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 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 (ATO) indicates that a substantial number of taxpayers have breached the caps, clearly inadvertently given the tax consequences. Under the caps that previously applied, only a small number of members were potentially affected and the complexities were manageable.

<u>Level of the caps</u>

ASFA considers that the caps that originally applied of $50,000 a year for those aged under 50, and $100,000 for those 50 and over would be appropriate going forward. If there were a concern about those who already have a substantial superannuation balance benefitting from such caps, then the higher caps could be linked to having no more than a specified level of superannuation savings in the year that contributions are made.

ASFA considers that such caps address the equity issue in that they are sufficient in limiting the quantum of assets a wealthy individual could build up in the tax-advantaged superannuation system.

ABS figures show that of the 1.25 million persons making salary sacrifice contributions to superannuation in 2007, only around 30% have superannuation account balances in excess of $150,000. Over 60% of those making such contributions are aged over 45, accounting for 78% of salary sacrifice contributions.

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 in the context of the financial circumstances of the Government at the time. ASFA accepts that the GFC 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 (as proposed by Government in its response to the Henry Report recommendations) is required to permit adequate levels of catch-up funding.

Recommendation 7: ASFA recommends that superannuation funds be provided with 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. This relief should be at least until 30 June 2013 or preferably be permanent.

A number of 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 are generally 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 Capital Gains Tax (CGT) relief following the GFC when most funds accrued capital losses. The relief provided 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.

While ASFA welcomed the original announcement by the Government, which sought to address an issue critically affecting the superannuation industry arising out of the GFC, and commended the Government on its timely response to this issue, our concern has always been with the limited timeframe in which the relief is to operate and the requirement to complete the transaction within a single tax year.

ASFA believes there are strong public policy reasons for:

- The relief to be permanent.
- As a minimum the current relief being extended for two years.
- The 12 month rule to be abolished.

The reasons the Government should provide permanent relief

ASFA appreciates that, despite the Cooper Review's recommendation for permanent relief, the Government may wish to use the policy of temporary relief to concentrate trustees' minds on mergers and to not encourage a delay of such considerations. It is our view however, that the use of temporary relief in this way is a rather blunt instrument with which to try and achieve the desired outcome. It also might be counterproductive in that the lack of relief in the near future many rule out most mergers, at least until there are no remaining capital losses to be carried forward.

Limiting the future availability of relief to circumstances in which APRA requires, on the grounds of current insufficient scale, a MySuper product to merge with another MySuper product might mean that relief in future is never provided. Such a power is one that APRA would not use lightly. Few if any trustees would consider such a process as the optimal way to arrange a merger.

Historically, the primary considerations leading to fund mergers have been major changes in the governance or legislative framework for funds. The lack of availability of relief is seen as a powerful argument by trustees in support of not merging.

Permanent relief would ensure that the ongoing and constant re-evaluation by trustees as to the appropriateness of a merger will not be affected by the absence of rollover relief. That is, it would not be a barrier to trustees making a merger decision that would otherwise be in the best interests of fund members.

Discussions leading to a final decision to merge funds may take extensive periods of time and consideration of CGT issues is but one part of the process. As recently reported in the press, discussions on one proposed merger between two industry funds have been underway since November 2009 and talks are due to resume in February 2011. This would put the timing of a merger well beyond June 2011. In this context, the availability of temporary CGT rollover relief cannot be seen as a driver of merger talks. However, the absence of permanent rollover relief may be viewed by one of the funds as a deal breaker.

The issue of CGT relief (or lack thereof) can also be very important for providers of retail superannuation products. A number of providers operate a number of superannuation funds. A lack of CGT relief can inhibit product rationalisation, including transferring members from legacy products to more modern superannuation products. Product rationalisation generally will provide benefits to both fund members and product providers.

In this context, the expiry of temporary relief will lead to a situation where at all times thereafter, or until a major change occurs that leads to the then government providing another round of temporary relief, the absence of CGT rollover relief may act as an impediment to further rationalisation. This impediment occurs not only where funds have unrecouped capital losses, but also where they have net unrealised capital gains (as without the relief, the merger results in bringing forward the date on which the capital gains tax is payable in relation to any such gains).

It should also be noted that the present relief enables trustees of self managed superannuation funds (SMSFs) to close their funds and transfer assets to a larger fund where they have reached the conclusion that an SMSF is no longer suitable for members' needs. This may occur where the members move overseas for a period, or the members just conclude that their current situation makes it difficult (or they are unwilling) to fully discharge their trustee obligations, or they consider that they are unable to achieve investment returns equivalent to those of larger funds.

While ATO statistics indicate that each year about 30,000 new SMSFs are established and about 3,000 are wound up, ASFA considers these figures significantly understate the number of SMSFs that may close over the coming years due to the "aging" of trustees and likely increased regulation in these areas. Presently more than 25% of all SMSFs have less than $200,000 in net assets, which many observers consider is the threshold level of assets below which an SMSF is unlikely to be an economic proposition. Further, 53% of new SMSFs cite their belief that they can outperform the larger funds as a key reason for establishment of their funds. Generally it can take some years before trustees reach the conclusion that this may not be the case.

The conclusion is that there will always be a percentage of SMSF trustees that have or should be reaching a decision to close the fund and move the members' benefits into a larger fund. In this context, permanent relief is an important and potentially critical issue for appropriate decision making in the best interest of the member and the economic efficiency of the industry.

The continuing existence of capital losses

The issue of capital losses within superannuation funds, and the resultant impediment to mergers in the absence of CGT rollover relief, has not yet gone away. ASFA has sought information on the ongoing impact from major Australian accounting firms. The advice we have received is that, in their reviews of funds' financial statements as at 30 June 2010, many funds still had tax benefits associated with capital losses in their accounts equal to 1.5% or more of their net assets. Typically this percentage tends to be higher in smaller funds (i.e. those funds with less than $1 billion in assets). In these funds, which are often the most active in considering mergers, percentages of 2.5% or 3% of net assets were not uncommon.

Unless equity markets rise by 25 or 30% between now and 30 June 2011, it is likely that many funds, especially smaller funds that are facing pressure to consider merging, will still have significant unrecouped tax benefits associated with capital losses as part of their overall net assets at that date.

To the extent that this is so, the absence of CGT rollover relief will mean that member equity considerations may result in trustees of smaller funds not being able to sanction mergers, notwithstanding the other long-term benefits from rationalisation that may arise.

For example, where a smaller fund has 2.5% of its net asset position represented by the unrecouped tax benefits associated with capital losses, this means that a member with an account balance of $100,000 will only have $97,500 transferred to the successor fund. The other benefits of rationalisation arising from a merger would need to be large enough to more than compensate for the immediate loss to members of 2.5% of their account balances before the trustees of the smaller fund could sanction such a merger.

ASFA submits that, given the likely extent of unrecouped capital losses at 30 June 2011, the Government should announce in the May 2011 Budget its intention to either:

- Extend the present expiry date for a minimum of two years beyond 30 June 2011; or
- Provide permanent relief.

For how long should the Government extend the temporary relief?

The timeframe for recoupment of capital losses by superannuation funds is likely to extend to at least 30 June 2013 and possibly one or two years beyond that.

ASFA submits that the Government should extend the temporary relief to at least 30 June 2013, with a commitment that in the three months leading up to 30 June 2012, the Government will liaise with industry to determine the extent of the remaining unrecouped capital losses, particularly in the smaller funds sector (i.e. funds with less than $1 billion in assets). Should it be determined that significant remaining unrecouped capital losses exist, the Government would extend the temporary relief until 30 June 2015.

Requirement to complete the transaction within a single tax year

ASFA seeks the removal of the restriction in section 310-45(3) so that, in more complex fund mergers, the law can accommodate the need to transfer assets from the ongoing fund in several stages, particularly where that ongoing fund has a pooled superannuation trust or similar vehicle to hold its investment.

As the industry continues to rationalise, the value of mergers continues to increase. The practicalities are that in significant sized mergers the relevant transfers of assets may not occur wholly within a single tax year.

In this regard, we are aware of at least one large fund merger already in progress, where:

- The first of the assets is anticipated to be transferred as early as February 2011 (comprising only non-CGT assets such as cash and fixed interest in the first instance); and
- The last of the assets may not be transferred until close to the completion date for the merger (13 June 2013). Indeed, if rollover relief is not appropriately extended, the need to recoup all relevant capital losses within the present fund prior to the merger completion may see the date for the merger being later still.

In relation to this fund merger alone, the absence of rollover relief may have detrimental consequences for more than 150,000 fund members.

Some of the impediments to funds merging in a single year include the requirement to:

- Determine which assets are to be transferred and which are to be realised and undertake the necessary transactions;
- Transfer large volumes of assets and their cost base information from a number of investment systems;
- Transfer large volumes of member records from a number of registry systems;
- Implement large-scale system changes and/or enhancements;
- Execute a number of bulk transfers of members from one fund to another;
- Review the trust deed of each fund to ensure they have the power to engage in a successor fund transfer;
- Further assess whether the transferee fund has equivalent rights and obtain various approvals from the trustee;
- Satisfy the legal tests that involve a detailed comparison of the features of each fund (e.g. fees, insurance benefits, etc.) to ensure the no-disadvantage test is satisfied;
- Meet the "significant event" requirements by communicating with the affected members; and
- Complete an assessment of the best trustee makeup.

ASFA submits that as a better integrity measure, the "single tax year" rule should be replaced by a condition that requires the transfer to be subject to a public announcement by both the transferor and the transferee superannuation funds that they will be merging, and that the announcement must specify a timeframe during which the merger will be completed.

Recommendation 8: ASFA recommends that if further drawdown relief is to be provided for holders of account based income streams, this relief be announced as soon as possible and no later than by Budget night 2011.

The Government, shortly before the end of the 2009-10 financial year, provided self-funded retirees with further drawdown relief for account based superannuation pensions in the 2010-11 year.

Drawdown relief over 2010-11 and the preceding two years helped retirees with account based pensions by reducing the need to sell assets at a loss in order to meet the minimum payment requirement.

Minimum payments are determined by age and the value of the account balance as at 1 July each year.

The minimum annual payment rule is designed so that retirees drawdown on their superannuation capital over their retirement. This rule recognises that superannuation is designed as a retirement savings vehicle with substantial tax concessions.

Many self-funded retirees with account based pensions have suffered significant capital losses on their pension portfolios due to the impacts of the GFC. Figures prepared for ASFA indicate that in 2007-08 the average return for a superannuation fund was negative 8% and in 2008-09 it was negative 13%. In 2009-10 the average return was 10.5%. While average returns are not yet known for 2010-11, preliminary figures indicate an average return for a balanced fund of around 7% for the six months to the end of December 2010.

There are arguments both ways regarding whether it would be appropriate to further extend the relief. Some organisations representing largely self-funded retirees have argued for continuation on the basis that past losses are still being recovered. In this context, as noted in the previous section, most superannuation funds still have carry forward tax losses.

On the other hand, the relief has already been provided for a number of years and markets are beginning to recover. Also there was no increase in drawdown factors in those years when there were above average returns.

ASFA appreciates that this will be a judgment call by the Government. However, whatever decision is made it is important there be an announcement well before the end of the financial year, preferably by Budget night. Superannuation funds are required to communicate with every member who has an account based income stream prior to the commencement of the next financial year in order to determine the drawdown factor (which has to be at least the minimum factor) that the member wants to use. If the minimum factor is not known until just before the start of the next financial year, this leads to confusion, additional communications, and reworking of systems and processes. This leads to increased costs which will have adverse consequences for those with account based income streams and for superannuation fund members more generally.

Recommendation 9: ASFA recommends that the current legislation and regulatory practices which restrict product development in the retirement space be amended or changed as follows:

- **Abolish Income Ruling IT 2480**
- **Modify or repeal SIS regulation 1.06(2)**
- **There be co-operation between the Regulators in terms of approving new retirement products. Currently product providers must deal separately with the ATO, APRA, ASIC and DFACS.**

Post retirement products form a substantial part of the overall superannuation system. One set of estimates suggest that in 2010 there was nearly $365 billion (around 30% of total superannuation assets) in the post retirement component of the superannuation sector. A large part of this ($115 billion) was in retail funds and around $192 billion was in SMSFs with $19 billion (but rising) in retirement products offered by industry funds.

While a number of public sector funds provide (or even require) benefits in the form of a lifetime pension, almost all other retirement products are in the form of account based products. With these, the account holder has the benefit of all the investment earnings together with preferential tax provisions. However, if the individual lives longer than they expect and/or they drawdown the investment at too fast a rate, then they can run out of money in their old age (or even not very old age).

Voluntary take-up of lifetime annuities in Australia is very low, with only about 1% of retirement assets in such superannuation products – driven mainly because of concessional social security means testing that was applied to such annuities at one point in time.

Since those concessions were withdrawn new sales of life annuities have dropped to under $10 million in aggregate a year.

There is no doubt that the current Australian post-retirement income market is not as developed as it could be. Reasons for this include:

- the lack of long-term government indexed bonds with which to back longevity insurance products;
- taxation disincentives for life annuities compared to other retirement products; and
- a desire by Australians to retain access to their capital.

The Government could play a crucial role in setting better rules for financial products providing retirement income. The introduction of "new generation" retirement products would enable retirees to retain the investment risk (as they do now through account based pensions) but share the financial risks of individual longevity through pooling. Such products are well established in other markets.

As noted above, the government could do this through setting more appropriate tax and regulatory rules for income streams. We are also moving to a situation where there will be more government debt. It would not be unreasonable for some part of this to be in government bonds which have an interest rate linked to movements in the Consumer Price Index.

In regard to current specific regulations impacting on providers of post retirement products, Regulation 106 is unnecessarily prescriptive and restricts innovation in the design of annuities.

Deferred annuities would also be made more attractive if they were regarded in all circumstances as a pension product (rather than being regarded as still in the accumulation phase) with the investments standing behind the deferred annuity receiving the same tax treatment as assets supporting other pension products.

In the absence of any requirements for retirees to take retirement income products which deal with longevity, it may now be the time to introduce incentives to take them up. For instance, a meaningful but not overly expensive option for government might be to provide an Age Pension means test concession for retirees who invest more than, say 25% of their superannuation savings in a longevity insurance or lifetime income stream product. Annuities also currently receive harsher treatment under Aged Care and Centrelink rules than some other forms of income and investments. Providing more uniform treatment of all forms of post retirement assets and income would make annuities more attractive in the market.