Supplementary submission in response to the Tax Discussion Paper

July 2015

The Association of Superannuation Funds
of Australia (ASFA)

About ASFA

ASFA is a non-profit, non-politically aligned national organisation. We are the peak policy and research body for the superannuation sector. Our mandate is to develop and advocate policy in the best long-term interest of fund members. Our membership, which includes corporate, public sector, industry and retail superannuation funds, plus self-managed superannuation funds and small APRA funds through its service provider membership, represent over 90 per cent of the 14 million Australians with superannuation.

A need for further changes?

ASFA considers that there is no urgency to make changes to superannuation. Any changes need to be well considered and examined as part of a holistic review. The Tax White Paper process provides that opportunity.

ASFA also endorses the government's objective of ensuring a desirable level of stability of policy settings for superannuation. This will assist in maintaining consumer confidence in superannuation.

In ASFA's submission in response to the Tax Issues Paper, we reviewed superannuation system against the objective and principles of the system. In particular we reviewed the system against the principles of:

- adequacy
- equity
- sustainability
- simplicity.

That submission outlined how the superannuation system is operating well against these principles. It is already reducing the cost of the Age Pension by $7 billion a year and as a result of superannuation, the proportion of people expected to receive the full pension has fallen from 44 per cent in 2000 to 25 per cent today, and will fall to 23 per cent by 2023.

Over the past five years, there have been a substantial number of reforms to the system that have only recently been implemented, or are in the process of being implemented, or are being legislated, or are yet to be fully considered. These changes have had a significant impact on superannuation fund members and the industry. The changes need time to take full effect and for consequences and costs to come to light.

While ASFA sees no urgent need for reform, in our first submission to the Tax White Paper we presented two reforms for discussion and consideration over the long term to develop a more sustainable and equitable system. These reforms arise from ASFA's review of the system against the objectives and principles of superannuation and they should be given full and in depth consideration as part of the holistic Tax White Paper process. The recommendations are:

1. There should be a ceiling where the system stops providing taxpayer support for accumulating retirement savings, or supporting incomes in retirement, and the appropriate level in today's dollars is a balance of $2.5 million. It can be argued that tax concessions above this level contradict the equity and sustainability principles of superannuation.
2. There are also gaps in the system, in particular regarding those who have broken work patterns.

In response to the expansion of the mandate for the Tax White Paper to include the full retirement incomes system, ASFA has undertaken additional analysis. In doing so, ASFA has again applied the principles of the superannuation system. Arising from this, ASFA has concluded there is no urgent need for reform. However, ASFA is recommending two additional changes to the retirement income system that should be considered in the long term and has reviewed several positions outlined in the first submission.

The two additional recommendations are:

1. Broaden the coverage of superannuation
2. The social security system should provide limited immediate incentives for income streams offering long-term longevity protection.

Improving adequacy of retirement incomes and spreading coverage of superannuation

There is a strong policy case to extend the compulsory superannuation regime to include some or all of the self-employed. Nearly ten per cent of the labour force is self-employed. Only a relatively small number of the self employed have business assets sufficient to support a comfortable standard of living in retirement. While tax concessions have led to some self-employed saving for retirement through superannuation, average balances and coverage have remained relatively low.

While account balances are growing as the superannuation system matures, many people will still retire with inadequate superannuation savings to fund the lifestyle they want in retirement.

There should be no further delay to the scheduled increases in the Superannuation Guarantee (SG) to eventually reach 12 per cent of wages, and desirably the timetable should be condensed. Women in particular benefit from the compulsory superannuation system.

The Low Income Superannuation Contribution (LISC) should be retained after 2017 as it assists low-income earners to achieve adequacy of retirement incomes. It also is consistent with the general principle of providing appropriate levels of support for individuals across the income ranges. Women form the majority of recipients of the LISC given that they make up nearly 70 per cent of part time workers.

ASFA considers that there needs to be greater flexibility in the system to allow those with broken work patterns to catch up.

Adoption of all these measures would particularly benefit women in terms of improving their financial independence and the adequacy of their income in retirement.

Impact of the changes to the Age Pension asset test

While the asset test will be less onerous at relatively low asset levels after 1 January 2017, it leads to a substantial reduction in Age Pension when higher levels of superannuation and other assets are held.

The changes to the asset test will have a mixed impact on the achievement of the objectives for the system proposed by ASFA. They will assist in containing the annual costs in aggregate of Age Pension payments and tax concessions for superannuation to below six per cent of GDP, principally through containing Age Pension expenditures at around three per cent of GDP. The changes will have little, or no effect, on the proportion of the population receiving the full Age Pension.

On the other hand, the changes will have an impact on adequacy of retirement incomes, reducing the average replacement rate in retirement from 65 per cent to below 60 per cent and reducing the proportion of the retired population, reaching the level of the ASFA Retirement Standard comfortable level from around 50 per cent of the population, to just over 40 per cent.

Couples will need to save around $130,000 more in order to finance a comfortable standard of living in retirement. For a single person, the additional amount is around $115,000.

The preservation age for superannuation

ASFA considers there are grounds for the preservation age being linked to the Age Pension age, such as a specified period less than the Age Pension age. ASFA suggests that such a gap generally should be five years. If this were done then the preservation age would increase automatically, and in synchronisation with, the Age Pension eligibility age.

However, if the eligibility age for the Age Pension were increased beyond 67, then the preservation age for superannuation should not automatically be increased, but be reviewed in light of labour force, health and disability experience of older workers at that time.

ASFA recognises that, as the Productivity Commission recently highlighted, there are many in the workforce who will not be able to continue to be employed beyond 60. If the preservation age were to increase to above age 60, the conditions of release in the *Superannuation Industry (Supervision) Regulation 1994* would need to be reviewed.

Better integration between superannuation income streams and the provision of the Age Pension

In order for the system to achieve its key objectives, superannuation should be used for retirement income and not for the provision of a bequest or the repayment of significant levels of debt. Providing incentives for people to take up an income stream can help achieve this objective.

Incentives could include giving beneficial social security treatment for at least some income streams. For example, income streams that meet certain prescribed criteria could be treated differently for Age Pension asset or income tests.

Recommendation 1

The Superannuation Guarantee be increased to 9.75 per cent as at 1 July 2016 and then increase by at least 0.25 per cent each year until it reaches 12 per cent.

Recommendation 2

The Low Income Superannuation Contribution be retained beyond 2017.

Recommendation 3

Broaden the coverage of superannuation.

Recommendation 4

A limit of $2.5 million be placed on the superannuation funds an individual can rollover to commence an income stream in retirement. Amounts above this ceiling should remain in the accumulation phase and continue to attract the nominal earnings tax of 15 per cent or be removed from superannuation.

Recommendation 5

Non-concessional contributions should also be capped at $1 million over a lifetime to prevent very large balances from accruing in the future as an integrity measure to complement the $2.5 million capital cap.

Recommendation 6

Concessional contribution caps should be changed in such a way that individuals with broken work patterns are able to make sufficient contributions. Further work also needs to be undertaken to evaluate methods for improving flexibility in superannuation to allow individuals with broken work patterns to make "catch-up" contributions to achieve a higher income in retirement.

Recommendation 7

The preservation age should be linked to the Age Pension age and should be set at five years less than the Age Pension age, up to a maximum age of 62.

Recommendation 8

The social security system should provide limited immediate incentives for income streams offering long-term longevity protection.

Introduction

The expansion of the Tax White Paper process to include the full retirement incomes system and the extension of time for submissions is an opportunity to review the interaction of superannuation and the Aged Pension system.

This submission reinforces and reiterates previous ASFA submissions on the taxation of superannuation and the provision of retirement incomes. Previous submissions by ASFA include:

- Submissions to the Financial System Inquiry (FSI)
- Response to the Final Report of the Financial System Inquiry
- Response to the Tax Discussion Paper
- Submission to Treasury on the Review of Retirement Income Stream Regulation.

In response to the expanded mandate, this submission extends ASFA's analysis in the first submission to include broader issues and focuses more closely on some issues already raised.

This submission provides additional information on the interaction of the Age Pension and superannuation, including the future impact of the recent changes to the asset test on retirement outcomes and implications for those planning for retirement.

In addition, the submission takes on board the analysis in the recent Productivity Commission (PC) report, *Superannuation Policy for Post-Retirement*, that was released on 7 July 2015. That report confirms that there is no urgency to make changes to superannuation immediately, and that any changes need to be part of a holistic review.

ASFA considers that the superannuation system is operating well, and is already reducing the cost of the Age Pension by $7 billion a year. As a result, the proportion of people expected to receive the full pension has fallen from 44 per cent in 2000 to 25 per cent, and will fall to 23 per cent by 2023. Following the changes to the asset test that will come into effect from 1 January 2017, the proportion of those on the part Age Pension will fall from the current 25 per cent to 16 per cent by 2023. This will make the Age Pension bill more affordable, but it will have an impact on adequacy of retirement incomes for those affected.

The Productivity Commission's analysis indicates that Australians are prudent with their superannuation savings, which is consistent with previous research, helping debunk the myth that people quickly spend their superannuation at the time of retirement. The truth is that 83 per cent of superannuation assets are taken as an income stream at retirement and, as the system matures, this number is likely to reach 96 per cent by 2025.

However, the Productivity Commission also identified some gaps in the system, in particular in regard to those who have broken work patterns. ASFA considers that there needs to be greater flexibility in the system to allow those with broken work patterns to catch up and that this should be considered as part of the Tax White Paper process. This issue was discussed in ASFA's first submission and, here, we reiterate the need for this issue to be considered by the Tax White Paper.

Reflecting the wider mandate, ASFA is making two recommendations in addition to those made in its first submission.

First, compulsory superannuation should be extended to some, or all, of the self-employed. There is a strong policy case to extend the compulsory superannuation regime. Nearly ten per cent of the labour force are self-employed. While tax concessions have led to some self-employed saving for retirement through superannuation, average balances and coverage have remained relatively low.

By not saving through superannuation, there is a risk that many self-employed persons will not have sufficient funds for their retirement and will fall onto the Age Pension adding to the cost of the budget. Many self-employed persons do not have a business that can be sold for a substantial amount at the time of retirement. For a tradesperson their only business asset might be their tools of trade and a motor vehicle.

Second, the social security system should provide more, albeit limited, incentives for individuals to take out income streams which reduce longevity risk. Holding such an income stream reduces the risk of running out of superannuation, and some small changes to incentives in the retirement phase could increase the uptake of income streams and reduce this risk. Changes to the tax treatment of certain longevity retirement products during their deferral phase also would assist in making them more attractive to retirees. Changes to superannuation legislation are also required so that certain retirement products can be offered to the public.

While ASFA is advocating for these and other small changes to the system, any reforms need to be considered as part of a holistic review of the system and the Tax White Paper process provides such an opportunity. Any changes should also reflect and be consistent with the detailed goals of the superannuation system.

Ensuring adequacy of retirement incomes

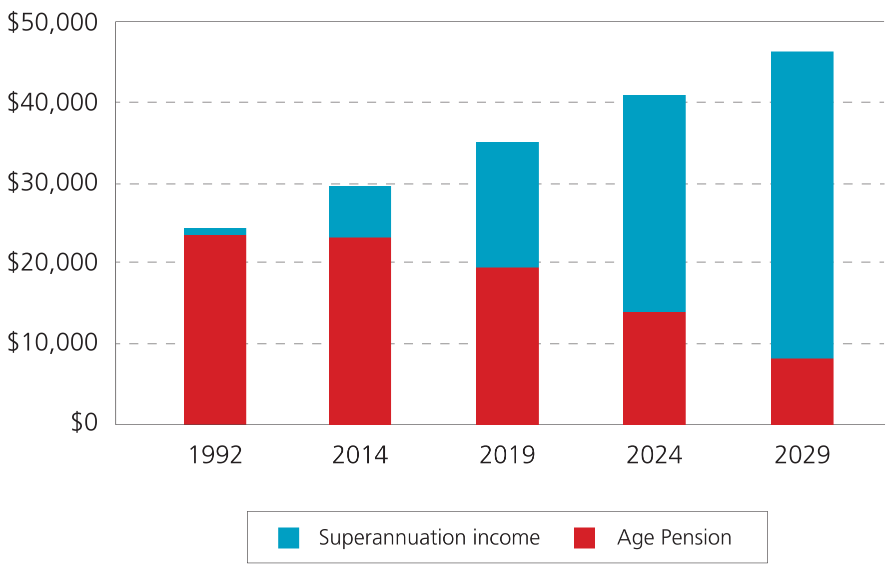
ASFA considers that retirement income policy should be designed to ensure that as many people as reasonably possible have an adequate income in retirement. Retirement savings adequacy continues to be a concern for many Australians. While account balances are growing as the superannuation system matures, many people will still retire with inadequate superannuation savings to fund the lifestyle they want in retirement. Most people retiring in the next few years will rely substantially on the Age Pension to fund their retirement as they have inadequate superannuation savings. However, as the compulsory system matures more individuals will retire with significant superannuation balances. This will both decrease reliance on the Age Pension and increase overall retirement income.

The superannuation system is delivering by:

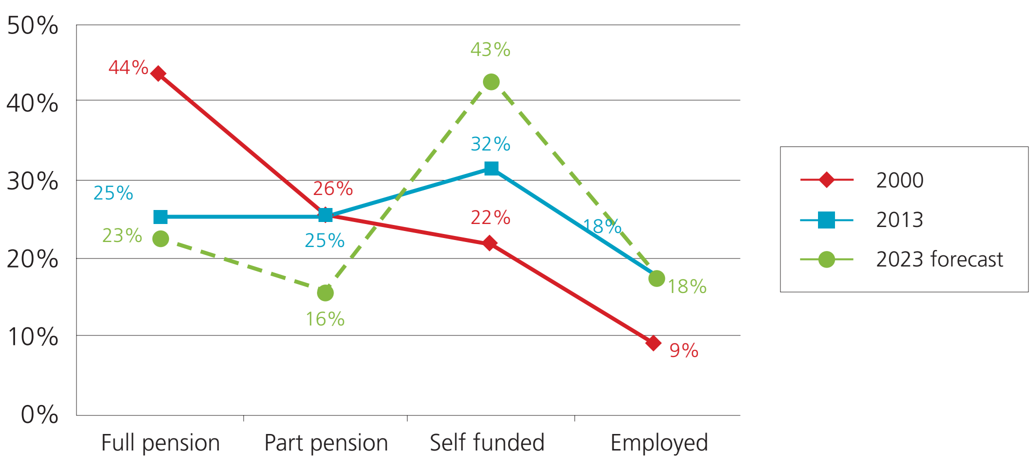
- enhancing retirement incomes
- reducing expenditure on the Age Pension to levels lower than they would otherwise be
- generating higher retirement incomes than would be the case without compulsory and voluntary superannuation contributions.

This is shown in the following two charts, which illustrate both developments in average retirement income and in reliance on the full and part Age Pension that will flow from individuals having more years on average of Superannuation Guarantee contributions at or near the highest rate legislated. The impact of the recent tightening of the asset test for the Age Pension is also reflected in the various projected outcomes.

Average retirement income at Age Pension qualifying age (in 2014 dollars)



Retirees at Age Pension eligibility age



Changes to the Age Pension assets test

The level of superannuation assets held by individuals has a substantial impact on Age Pension payments. For instance, due largely to increasing superannuation balances, the proportion of people receiving the full pension has fallen from 44 per cent in 2000 to 25 per cent, and is projected to fall to 23 per cent by 2023. Following the changes to the asset test, that will come into effect from 1 January 2017, the proportion of those on the part Age Pension will fall from the current 25 per cent, to a projected 16 per cent by 2023.

While the asset test will be less onerous at relatively low asset levels after 1 January 2017, it leads to a substantial reduction in Age Pension when higher levels of superannuation and other assets are held. The following tables provide further details. For some retirees the impact is significant, including cases where retirement income decreases by around 20 per cent. This will require many such retirees to drawdown on their capital to meet their expenditure needs.

The calculations in the tables assume an average investment return of seven per cent per year. While this is consistent with average historical investment returns for superannuation portfolios with around 70 per cent growth assets, the actual return that retirees will achieve will depend on the future performance of equity markets and the investment choices that are made. Many retirees may choose more stable but lower average return investment portfolios.

Lower investment returns impact on the total income in retirement. They do not lead to higher Age Pension payments given that both the income and asset tests do not take into account actual investment returns received in the case of account-based superannuation assets. Instead, investment returns are deemed in the income test and the asset test is related to total assessable assets, not investment income.

Table 1: The impact of the asset test changes on couple Age Pensioners

	Current Age Pension	Age Pension from 1 Jan 2017	Total current income with 7% investment return	Total income from 1 Jan 2017	Total income loss per couple	% reduction in income
200,000	$34,923	$34,923	$48,923	$48,923	$0	0.0
300,000	$34,865	$34,923	$55,865	$55,923	Gain of $58	
400,000	$30,965	$32,973	$58,965	$60,973	Gain of $2,008	
500,000	$27,065	$25,173	$62,065	$60,173	$1,892	3.0
600,000	$23,165	$17,373	$65,165	$59,373	$5,792	8.9
700,000	$19,265	$9,573	$68,265	$58,573	$9,692	14.2
800,000	$15,365	$1,773	$71,365	$57,773	$13,592	19.0
900,000	$11,465	0	$74,465	$63,000	$11,465	15.4
1,000,000	$7,565	0	$77,565	$70,000	$7,565	9.8
1,100,000	$3,665	0	$80,665	$77,000	$3,665	4.5

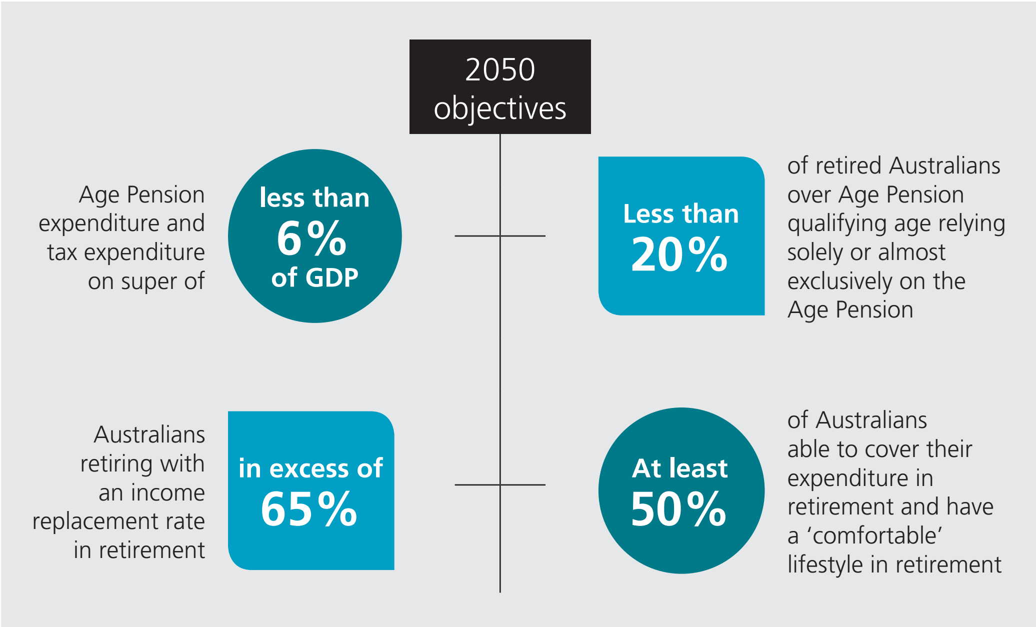
Table 2: The impact of the asset test changes on single Age Pensioners

	Current Age Pension	Age Pension from 1 Jan 2017	Total current income with 7% investment return	Total income from 1 Jan 2017	Total income loss per couple	% reduction in income
100,000	$23,166	$23,166	$30,166	$30,166	$0	0.0
200,000	$23,166	$23,166	$37,166	$37,166	$0	0.0
300,000	$19,676	$19,266	$40,676	$40,266	$410	1.0
400,000	$15,776	$11,466	$43,776	$39,466	$4,310	9.8
500,000	$11,876	$3,666	$46,876	$38,666	$8,210	17.5
600,000	$7,976	0	$49,976	$42,000	$7,976	16.0
700,000	$4,076	0	$53,076	$49,000	$4,076	7.7

The next figure sets out goals that ASFA has proposed for the retirement income system:

- Capping government direct and indirect expenditures on retirement income at six per cent of GDP or less (this is a very modest amount compared to developed countries and most developing countries)
- Limiting the percentage of retirees on the full Age Pension to 20 per cent or less
- Allowing 50 per cent or more of retirees to achieve the comfortable ASFA Retirement Standard in retirement
- Supporting a replacement rate of income in retirement of 65 per cent or more on average.

Objectives of the superannuation system, 2050



However, the outcomes described above are dependent, at the very least, on the SG rate reaching 12 per cent as currently proposed, taxation of superannuation remaining basically unchanged, allowing the bulk of Australians to benefit from tax concessions which both support contributions and the investment earnings of account balances.

If the SG does not increase to 12 per cent and/or there were significant adverse changes to the taxation of superannuation, then outcomes would be less favourable for both individuals and for the government in terms of Age Pension expenditures.

The recent changes to the Age Pension asset test will have a mixed impact on the achievement of the objectives proposed by ASFA. They will assist in containing the annual costs in aggregate of Age Pension payments and tax concessions for superannuation to below six per cent of GDP, principally through containing Age Pension expenditures at around three per cent of GDP. The changes will have little, or no effect, on the proportion of the population receiving the full Age Pension.

On the other hand, the changes will have an impact on adequacy of retirement incomes, reducing the average replacement rate in retirement from 65 per cent to below 60 per cent and reducing the proportion of the retired population reaching the level of the ASFA Retirement Standard comfortable level, from around 50 per cent of the population to just over 40 per cent. Couples will need to save around $130,000 more in order to finance a comfortable standard of living in retirement. For a single person the additional amount is around $115,000.

Table 3 provides further details on the difference in retirement outcomes that flow from making contributions at 12 per cent compared to 9 per cent. It also illustrates the impact on retirement savings targets that flow from the new asset test rules. The minimum balances required for couples and singles to achieve a comfortable standard of living in retirement are substantially higher than those previously applied. The reason for this is an increase in private income is needed to offset the fall in the Age Pension across a wide range of assets held in retirement.

Table 3: Prospective superannuation balances at different contribution and wage levels

Contribution level	$30,000 wage	$50,000 wage	$100,000 wage
Lump sum if contributions made at the rate of 9 per cent	$110,000	$183,000	$366,000
Lump sum if contributions made at the rate of 12 per cent	$146,000	$244,000	$487,000
Boost to final retirement savings	+$36,000	+$61,000	+$121,000
Cost of extra tax concessions on contributions per annum	+$135	+$248	+$705
Total income tax paid on wage per annum	$2,247	$7,797	$26,447
Lump sum needed for a single person to achieve comfortable under old asset test rules	$430,000	$430,000	$430,000
Lump sum needed for a single person under the new asset test rules	$545,000	$545,000	$545,000
Lump sum needed for a couple to achieve comfortable under old asset test rules	$510,000	$510,000	$510,000
Lump sum needed for a couple under the new asset test rules	$640,000	$640,000	$640,000

Adequacy of retirement savings and retirement income is a more significant concern for women. Women on average tend to live longer in retirement than men, but often retire with less retirement savings than men. Women still lag substantially when it comes to average account balances at all ages. Not increasing the SG to 12 per cent would tend to reinforce the gender gap as women on average tend to rely more on SG contributions than do men, who are more likely to make voluntary contributions to superannuation.

Consequences of not increasing the SG to 12 per cent

As legislation currently stands, the SG is paused at 9.5 per cent until the year 2021-22 and the LISC is scheduled to cease on 30 June 2017.

As noted above, this will impact particularly on women.

Gender income inequality in old age reflects a number of factors, including the effect of women's family responsibilities on their career paths and divisions of labour in the paid labour force. In particular, women are more likely to work in lower paid industries and sectors of the economy. According to data from the Australian Bureau of Statistics, as at May 2014 the average ordinary full-time weekly earnings of Australian men was $1,560, significantly higher than the $1,274 earned by women.

With on average fewer years in the work force and lower pay, average retirement savings are lower for women. Women currently retire with just over half the average balance that men have ($105,000 compared to around $200,000 for men).

For those with superannuation and who are aged 60 to 64, and on an income of around $70,000 a year, women have an average balance of $170,000 compared to around $260,000 for men. All these figures are well below what will be delivered for the person on average earnings after 35 years of contributions at 12 per cent of wages.

An increase in the SG particularly benefits those on average and lower than average incomes given that they are the ones most likely to make contributions no greater than the compulsory rate. Women are also particularly affected as nearly 70 per cent of part time workers are women. Those groups on average and below average incomes generally have lower than average voluntary superannuation savings with compulsory superannuation contributions needed to support a comfortable standard of living in retirement, or even to support an adequate retirement income.

Retaining the LISC

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
2. recognition that in a country which supports a progressive income tax system, appropriate levels of support should be provided for individuals across the income ranges.

The LISC assists in meeting both these goals.

A number of commentators have observed that the tax arrangements that previously applied for individuals with taxable income less than $37,000 a year, prior to the introduction of the LISC, did not provide any real incentive for such individuals to make contributions. For those on the zero marginal tax rate there was an actual disadvantage. For those in the second tax bracket, which currently has a marginal rate of 19 cents in the dollar, the 15 per cent tax on employer and other assessable contributions is not very concessional. A member on $37,000 will only pay $214 less tax on salary and SG contributions compared to salary alone.

Every single dollar of concessional contributions is taxed at 15 per cent in the fund from the first dollar, as opposed to zero tax payable on incomes up to $18,200 and then 19 per cent on only that income, which is in excess of $18,200 up to $37,000 (which is where the LISC cuts out).

The LISC currently benefits 3.6 million Australians on low and modest incomes, including 2.1 million women with a total cost to the budget of around $900 million a year. It benefits around 30 per cent of workers, who in 2009-2010 only received around 1.2 per cent of total superannuation concessions. The introduction of the LISC nearly doubled the amount of tax assistance for persons earning less than $37,000 a year.

For a person earning just $37,000 a year, aged 30 and retiring aged 65, if the LISC applied over their working life it would boost their superannuation balance, in today's dollars, **by around 20 per cent**, from $200,000 to $240,000.

While the superannuation co-contribution assists low-income earners grow their superannuation balances, it is only used by a minority of low-income earners as it requires the individual to make additional personal contributions to superannuation. The LISC benefits many more individuals and also removes a tax disadvantage for low-income earners.

The LISC is a sound long-term public policy in relation to superannuation and retirement incomes, especially given the financial implications of the ageing population. By boosting private retirement savings it helps contain future expenditure on the Age Pension.

Extending compulsory superannuation to the self-employed

There is a strong policy case to extend the compulsory superannuation regime to include some, or all, of the self-employed. Nearly 10 per cent of the labour force is self-employed. Only a relatively small number of the self-employed have business assets sufficient to support a comfortable standard of living in retirement. While tax concessions have led to some self-employed saving for retirement through superannuation, average balances and coverage have remained relatively low.

While many self-employed people and small business owners consider that their business is their superannuation, a considerable proportion of self-employed people do not own a business with any material goodwill or value, other than their labour. Around 50 per cent of the self employed do not have significant business or other financial assets. According to research from the Productivity Commission, over 25 per cent of the self-employed are dependent contractors, in that they have working arrangements similar to employees and are not conducting a business as such.

Other self-employed people run businesses where there personal labour is the primary value of the business. For instance, in the case of a plumbing or carpentry business, the sale value of the 'goodwill' of the business might be very limited when the individual retires.

Furthermore, even where there is an ongoing business of some value, there is still a risk to individuals where their business fails, or the value of the business at retirement is diminished. This can leave them with inadequate savings to fund their retirement.

In addition, the fact that the SG is not payable with respect to the self-employed is a distinction within the SG regime that, at best, is a source of confusion and, at worst, is exploited by the artificial creation of arrangements whereby individuals are considered to be self-employed to avoid the need to pay SG. Recent research commissioned by Cbus, AustralianSuper and REST, and performed by Tria Partners, reveals systemic issues with respect to employer compliance with their SG obligations. In particular, the research indicated that over 50,000 persons were involved in sham contracting arrangements.

Accordingly, compulsory superannuation should be extended to some, or all, of the self-employed. While this may pose some design challenges with respect to the concept of 'income' against which compulsory superannuation is to be applied, and the person/entity who is responsible for making the superannuation contributions, this should not preclude work being done in this area. Consideration also would need to be given to carving out those self-employed persons who have substantial business assets.

Ensuring equity is achieved in regard to the taxation of superannuation

As noted in the introduction to this submission, ASFA considers there is evidence that both superannuation and the Age Pension are working well and are delivering retirement outcomes that Australians need and deserve. Retirement outcomes will continue to improve as the compulsory superannuation system matures in the sense that more Australians retire with the benefit of many years of contributions at, or near, the eventual maximum compulsory rate.

However, some improvements to equity could be made. The pace and timetable of these changes would need to be consistent with maintaining confidence in the superannuation systems. Changes which would have a favourable impact on all or many fund members of course would support confidence in the system.

Very high superannuation balances, equity and sustainability

While the tax concessions in superannuation are broadly equitable across different income levels, there is some intergenerational and intragenerational inequity when wealth distribution is considered.

Once a person has accumulated enough superannuation savings to generate an income that will fund a comfortable lifestyle in retirement (in terms of the ASFA Retirement Standard), or a reasonable replacement rate for higher income earners, it is arguable that they no longer need the same tax concessions in place to incentivise them to accumulate further savings, and to support the achievement of adequate retirement income.

Beyond that point, it is possible to argue that the accumulation of superannuation becomes more about using the tax-advantaged status of superannuation to build wealth for estate planning purposes, as opposed to delivering an income stream that provides a comfortable retirement.

Ongoing non-concessional contributions have also played a role in the creation of high balance accounts. An individual is currently permitted to contribute $540,000 in non-concessional contributions every three years up until age 65. Further contributions can be made by small business owners who retire and rollover the proceeds of the sale of their business into superannuation, making use of the capital gains tax concessions available. Self-managed superannuation funds (SMSFs) received over $18 billion in non-concessional contributions in 2012-13.

ASFA's view is that there should be a ceiling where the system stops providing taxpayer support for accumulating retirement savings, or supporting incomes in retirement, and the appropriate level in today's dollars is a balance of $2.5 million. It can be argued that tax concessions above this level contradict the equity and sustainability principles of superannuation. The $2.5 million cap is based on the following:

- a replacement rate for retirement income that is often used is 60 per cent of gross pre-retirement income
- for a person with an income of $200,000 a year, a reasonable upper limit for the provision of taxation concessions or other assistance is a drawdown of $120,000 per annum in retirement
- an income of $200,000 or below includes 90 per cent of the workforce
- $120,00 per annum is close to twice the ASFA Retirement Standard estimate for the income required for a 'comfortable' retirement
- using the minimum drawdown factor for a person aged 65 to 74 this would require a superannuation balance of $2.4 million if the person were to live to 90.

Many tax and related social security measures have an upper income or wealth limit for either paying less tax than the maximum rate, receiving the maximum benefit or receiving benefits at all. The $200,000 income level has been based on other upper limits and tax thresholds that apply. For example:

- the maximum income level at which employers are required to pay SG contributions is $203,240 a year

- the temporary ‘Budget repair levy’ cuts in on incomes over $180,000 a year, as does the top marginal personal income tax rate
- the base (most generous) tier for the health insurance rebate applies to those on $180,000 or less a year.

ASFA considers that individuals should not be permitted to have total capital underlying an income stream in the pension phase in excess of $2.5 million. Amounts in excess of $2.5 million could be commuted and rolled back into the accumulation phase and therefore be subject to the nominal 15 per cent tax on investment earnings, or withdrawn from the system by the individual. The $2.5 million converted into an income stream would remain tax free. For example, on retirement, an individual with a balance of $3 million could convert $2.5 million into a retirement income stream that would attract no earnings or benefits tax, while the balance of $500,000 could remain in accumulation and attracting the 15 per cent earnings tax, or be withdrawn.

Individuals who already have in excess of $2.5 million underlying income streams would be given a transitional period in which they could commute the excess balance in retirement phase and either rollover to the accumulation phase, or be paid a lump sum benefit. The cap would apply to individual’s balances, not the joint balances of couples.

Individuals, however, are still able to contribute significant amounts to superannuation through non-concessional contributions which are capped at $540,000 every three years up until age 65. This is inconsistent with the principle of equity, as those with high incomes and wealth have a greater capacity to contribute significant amounts of money post-tax and receive concessional tax treatment on earnings, sometimes for decades.

The amount of non-concessional contributions could be capped at $1 million per individual per lifetime. Once the cap were reached, no further non-concessional contributions could be made. This would reduce the capacity for very large balances to be built up in the future and is an integrity measure to complement the proposed cap of $2.5 million.

Broken work patterns and superannuation tax concessions

Broken work patterns, and their impact on affected individuals’ capacity to accumulate sufficient superannuation, are having a substantial effect on the adequacy and equity of the superannuation system.

A significant number of people experience broken working patterns, with time out of the paid workforce for reasons such as the provision of care-giving (be it children or other family members), to study, or as a result of unemployment or underemployment. In addition to this there is an increasing trend towards the casualisation of the workforce, with a higher proportion of roles being part–time, casual or performed through a contracting or sub contracting arrangement, as opposed to traditional engagement as a full-time employee.

The impact of broken work patterns on retirement incomes is an area where the current tax arrangements in superannuation do not meet the key principles of adequacy and equity. Policy solutions to deal with broken work patterns are not simple.

ASFA considers that concessional contribution caps should be changed in such a way that individuals with broken work patterns are able to make sufficient contributions. Further work also needs to be undertaken to evaluate methods for improving flexibility in superannuation to allow individuals with broken work patterns to be able to make ‘catch-up’ contributions so as to achieve a higher income in retirement.

For instance, if the concessional contributions cap were increased to $45,000 (indexed) to accommodate people being able to ‘catch-up’ in the making of concessional contributions, then this could be accompanied by an integrity measure in the form of a lifetime concessional contributions cap. The amount of concessional contributions which an individual would be able to receive over their lifetime would be capped at $1 million.

The preservation age for accessing superannuation

The Productivity Commission in its recent research paper modelled what might be the impact of increasing the preservation age above the already scheduled increase to age 60.

The Productivity Commission found that, consistent with expectations, raising the preservation age would lead to at least some people working longer and as a result accumulating more superannuation.

Modelling indicated that a gradual increase in the preservation age to 65 would have the following impacts:

- there would be a modest increase in the participation rate of older workers (of around two percentage points in 2055) - mainly among those with higher wealth at, or near, retirement
- households that delay their retirement are likely to do so by around two years and will have superannuation balances around 10 per cent larger in real terms when they retire
- there will be an indicative annual fiscal improvement mainly due to tax revenue increases from wealthier households
- changing the preservation age will have little, if any, impact on the workforce participation of individuals who retire involuntarily – almost one half of men and over one third of women who retire between the ages of 60 and 64.

ASFA continues to consider that the preservation age in general should be linked to the Age Pension age. This could involve setting the preservation age at a specified period less than the Age Pension age.

If this were done, then the preservation age would increase automatically, and in synchronisation with, the Age Pension eligibility age.

If a period of five years were adopted, this would see the preservation age increase, in a phased manner, from age 60 to age 62, as the Age Pension age increases to age 67. This would minimise the risk of the dissipation of superannuation monies prior to Age Pension age.

In making such a change, however, consideration would need to be given to those older Australians who, for a range of reasons including restricted abilities due to health issues and a lack of employment opportunities, may find themselves unable to find employment, or sufficient employment. If they are unable to access their superannuation, or the Age Pension, this will lead to an increase in both disability and unemployment benefits. There may, therefore, be a need for some form of early access in order to protect this group.

The impact of higher unemployment levels for this age group is to reduce the fiscal benefit to the government of raising the preservation age through the off-setting effect of the payment of increased unemployment benefits and Disability Support Pension. Perceived and real employer concerns with employing older workers need to be addressed to ensure as many people in this age group continue to be employed.

For these reasons, ASFA does not support the preservation age being automatically increased above age 62 if there were to be further increases in the eligibility age for the Age Pension beyond the current legislated age 67. An increase in the future, beyond age 62, would need to be considered in the context of health status and employment prospects at that time of those aged 62 and over.

If the preservation age were to increase to above age 60, the conditions of release in the *Superannuation Industry (Supervision) Regulation 1994* would need to be reviewed. In particular, the condition of release with respect to the cessation of employment with an employer who had contributed to the fund on, or after, age 60 could now occur prior to preservation age being reached.

Better integration between superannuation income streams and the provision of the Age Pension

In order for the system to achieve its key objectives[1], superannuation should be used for retirement income and not for the provision of a bequest, or the repayment of significant levels of debt. Providing incentives for people to take up an income stream can help achieve this objective.

Incentives could include giving beneficial social security treatment for at least some income streams. For example, income streams that meet certain prescribed criteria could be treated differently for Age Pension asset or income tests. This could include where they fund increased longevity protection through measures such as limiting access to return of capital during the payment phase, and having no death benefit.

This recognises that the member has 'locked up' capital, may be subject to counter-party risk and has a reduced, or even nil, residual capital value which can be left as a death benefit. There also would be eventual benefits to government in terms of reduced Age Pension expenditures, as assets would not run out until a later date.

Importantly, allowing members to acquire a range of income streams to suit the differing needs that retirees have over the span of their retirement, would enable them to better plan for their retirement.

For example, allowing a member to acquire a deferred income stream to fund their later retirement years would enable them to plan with more certainty how to use a more traditional account-based income stream during the first 15-20 years of their retirement, say until age 80. The commencement of a deferred income stream at age 80 would minimise the need for a substantive balance to be left in the original account-based income stream after 15 to 20 years, as the payments from the deferred income stream could supplement, or even form the bulk of, the member's income for the remainder of their retirement.

The need to provide protection against longevity risk is real and growing. Fifty per cent of people will live beyond the average life expectancy and most Australians will live at least 15 years after age 65 (that is, 66 per cent of males and 78 per cent of females live past age 80, with these percentages growing every year). There is a 15 per cent chance that one person in a couple will live past age 95.

Mercer analysis also highlights the importance of an appropriate legislative structure in relation to the post-retirement stage. It analysed the mortality rates of public sector pensioners and revealed (allowing for continued improvements in mortality) that most retiring white-collar workers are likely to live much longer than the current average life expectancy of 84.1 for men and 87 for women.

In this context, consideration could be given to restoring, at least partially, concessions for some superannuation income streams that provide financial protection in regard to the impact of longevity, with respect to the eligibility tests for social security income support payments, such as the Age Pension.

[1] ASFA's first response to the Tax Discussion Paper provides details on the objectives of superannuation.

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