SMSF Owners' Alliance
Limited ABN 96 161 052 464
Not-for-profit public company

18 January 2016

Hon Scott Morrison, MP
Treasurer
&
Hon Kelly O'Dwyer, MP
Assistant Treasurer
Parliament House
CANBERRA 2600

Dear Ministers

The best tax option for superannuation

We expect that superannuation will be high on your policy agendas as we enter 2016 with the Taxation White Paper shaping Government thinking in the lead-up to the election.

So we are taking the opportunity to write to you both on some key concepts and principles that we believe the Government should follow in determining whether any changes should be made to the superannuation system and what they might be.

Some people appear to think that tax reform is about raising more taxes and others think it is about implementing a political agenda.

We agree with the Government that our tax system should be structured to encourage effort, innovation and independence.

We used to have an EET superannuation system in which contributions and earnings on savings were tax exempt but with the final pension taxed. This system is generally recognised internationally as the most appropriate way of taxing superannuation. We currently have a TTE system (tax on contributions, tax on earnings and exempt on pension drawings).

It is now difficult to revert to the EET system and we proposed in our first submission to the Tax White Paper Task Force last May an alternative similar to that proposed by Dr Henry (and now Deloitte and others) with equal tax benefit on contributions. We took Dr Henry's proposal a step closer to the ideal EET system, **by exempting all super earnings from taxation**. To have a neutral budget impact the tax rebate ("equal tax benefit") on contributions is reduced from the 20% proposed by Dr Henry to 15%. Our modelling shows that this is a more efficient system than Dr Henry's, leading to better outcomes for more Australians with no budget impact. The impact of this proposal and alternatives should be compared with the EET system and considered against the following tests:

1. Is it fair in its treatment of all Australians? and
2. Are the tax concessions too large or too small to meet the objectives of the system?

Our strong understanding of "fairness" is that all Australians should be given equal opportunity and treated equally, with the progressive income tax structure and social security system being the drivers of redistribution to assist those who are truly vulnerable and unable to survive without such assistance. We disagree with some views (e.g. the Grattan Institute) that the Government should also use the superannuation system as another redistribution mechanism on the basis of need. We believe this is unfair and incompatible with a structure to support a vibrant liberal democracy.

The principal purpose of superannuation is to encourage the funding of retirement independent of Government. It is generally accepted internationally that people should be encouraged to save enough to fund a pension equal to 60 – 70% of their pre-retirement after tax income. We disagree with some recent comments that everyone should be constrained to fund a pension equal to 70% of **median** income. To be fair, most Australians should be given equal opportunity to save enough to retire on 70% of **their** pre-retirement income.

Q1 Is the system fair?

Under the current system, the superannuation tax concessions are greater (in dollar terms) for those on higher incomes, but these Australians also pay much higher taxes. Indeed the tax concessions **fall** as a percentage of taxes paid by those on higher incomes. On this basis the tax concessions do not appear unfair.

However, this is partly due to our very progressive income tax scale. If our upper tax thresholds were raised to more reasonable international standards then the Government should seriously consider moving to a system of equal tax benefit. Our modelling shows that such a system - with the tax rebate/benefit set at a level that allows the total removal of taxes on all super earnings (i.e. the TEE system)– is the most efficient in providing better outcomes for more Australians at the same cost to Government.

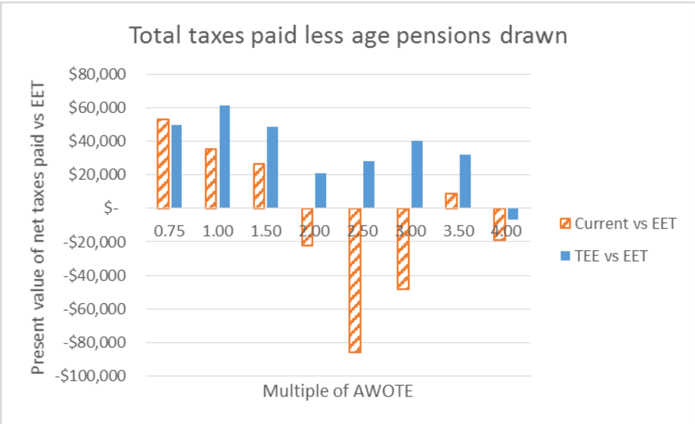
Q2 Are concessions too high or too low?

There has been much debate on whether the overall level of superannuation tax concessions are high enough or too high to achieve their purpose.

What is now accepted is that the cost is **not $30 billion** or so. Treasury have presented an alternative figure based upon a different benchmark and this suggested a tax expenditure closer to $10 billion.

However, rather than argue about benchmarks, a more practical measure is to compare taxes paid net of Age Pension receipts with the net taxes that would have been paid under the "ideal" EET system.

Our computer simulation model calculates the total taxes paid under the current system, net of Age Pension receipts, for Australians on a range of incomes. It then compares this, in present value terms, with the net taxes that would be paid by the same people under an EET system to achieve the target pension level.



We then also do the same comparison for our proposed TEE system vs the EET.

This graph shows that under our proposal the net tax receipts are generally higher than under the "ideal" EET system indicating that the tax concessions under our proposal are not too high.

It also shows the distorting impact of the current structure.

Limitation on super

The current contribution caps are too low to allow most Australians to achieve the target pension. Our analysis suggests that the annual contribution cap should be raised to $80,000 to achieve this but that $35,000 per annum would be an acceptable cap if we moved to our proposed TEE system.

We agree with ideas to allow more flexibility by a system of lifetime caps or allowing carry forward of unused caps.

Finally, another advantage of this TEE proposal is that it does not require complex grandfathering to avoid retrospectively taxing existing retirees who have saved in good faith under the current system.

We look forward to the opportunity to make further submissions on how to improve our superannuation system and to enter into a dialogue with Government on how to best implement such changes.

Yours sincerely

Bruce Foy
Chairman

About SMSF Owners

The SMSF Owners' Alliance is an independent, not for profit advocacy group that speaks up for the one million plus Australians with self-managed superannuation funds. Membership is confined to the trustees and beneficiaries – the owners – of SMSFs. In this way, we differ from most organisations that comment on superannuation policy and that largely represent managers and advisers.

Since we started in late 2012, SMSF Owners has made pre-Budget submissions each year and participated in major policy reviews, including the Taxation White Paper process. SMSF Owners participates in the ATO tax consultation process and sits on ASIC's Consumer Advisory Panel. We are often quoted in the media on issues of concern to self-managed fund owners.

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