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

Change super only for the better – don't kill it off with more taxes

3 June 2015

SMSF Owners says superannuation is working better than many of its critics claim, but there is room to improve its effectiveness. This is contrary to some critics of super who want to tax it more, risk killing off the incentive to save and leading to more Australians having to retire on the Age Pension 100% of which is paid for by the Government from taxes.

The policy challenge for Government is not how to extract more tax revenue from superannuation to fix budget problems or to respond to those who claim it is unfair. The challenge is how to make superannuation work better for more Australians.

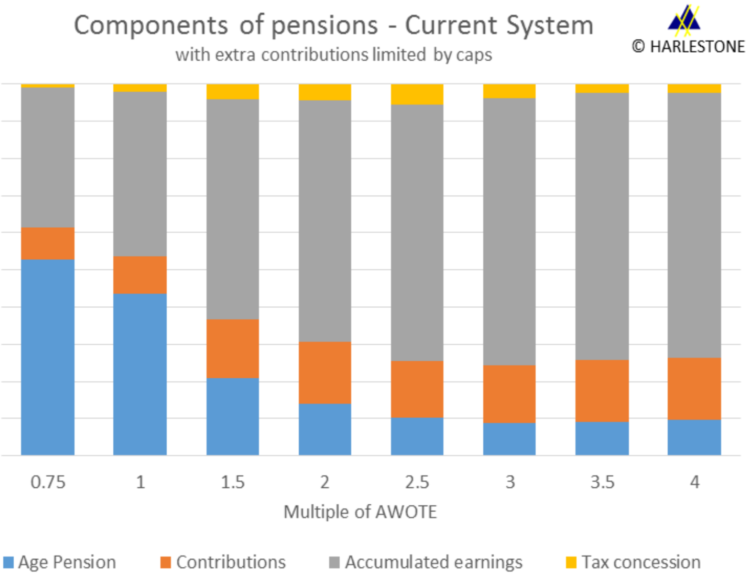
Our submission says governments must recognise that by far the largest component of people's retirement income from super is funded by their own savings and the earnings on their savings.

It's mostly our own money!

The following chart taken from our submission shows that the Age Pension is important for people on less than average weekly earnings but also illustrates the significance of accumulated earnings on super-funded pensions and the small contribution that tax concessions make to funding super.

For all income ranges, superannuation tax concessions make up only a small portion of the source of retirement income. The key point here is that the tax incentives should provide the incentive for people to save rather than spend their own money during their working life and so is a much better use of Government funds than 100% taxpayer funding of the Age Pension.

Graph 1



This graph shows the relative sources of funding of retirement pensions – both Age Pension and super-funded pension – for Australians on a range of incomes (measured as multiples of Average Weekly Ordinary Time Earnings).

Three ways in which the earnings on super savings could be improved are:

1. Improve and strengthen competition and choice amongst fund managers and investment product providers;
2. Simplify where possible the operation and administration of super; and
3. Reduce the taxation of superannuation earnings as recommended in the Henry Report.

To the extent such measures reduce costs and improve investment returns, the impact on super is dramatic and the chances of the system providing adequate super for more Australians is improved at no extra cost to the Budget.

With regard to point 2, we identify some of the complexities of super and encourage debate on which of these could be eliminated.

With regard to point 3, our submission stresses the importance of recognising the differences between tax concessions on super contributions and tax concessions on the earnings within super. We believe that there may be ways in which the **contribution** tax structure could be improved to provide a better incentive and concession to those on lower incomes.

At the same time, it is generally recognised that the income from savings should be concessionally taxed to encourage savings and our modelling demonstrates that, rather than add further taxes onto superannuation earnings, the largest positive impact on accumulated earnings would be the removal of tax on superannuation **earnings** altogether.

In our submission, we have therefore compared alternative taxation structures with the intention of seeing if there are better systems to the current one which would be tax neutral to the Government but achieve better outcomes for Australians. We believe there is a better way.

Towards a better system

It is generally accepted that an EET system (tax exemptions on contributions and earnings but a tax on withdrawals) is the most economically effective system and one that works in many countries. However, it may be very difficult and complex for any Government to turn 180 degrees and revert to the system which Australia had before superannuation taxes were introduced in the late 80s.

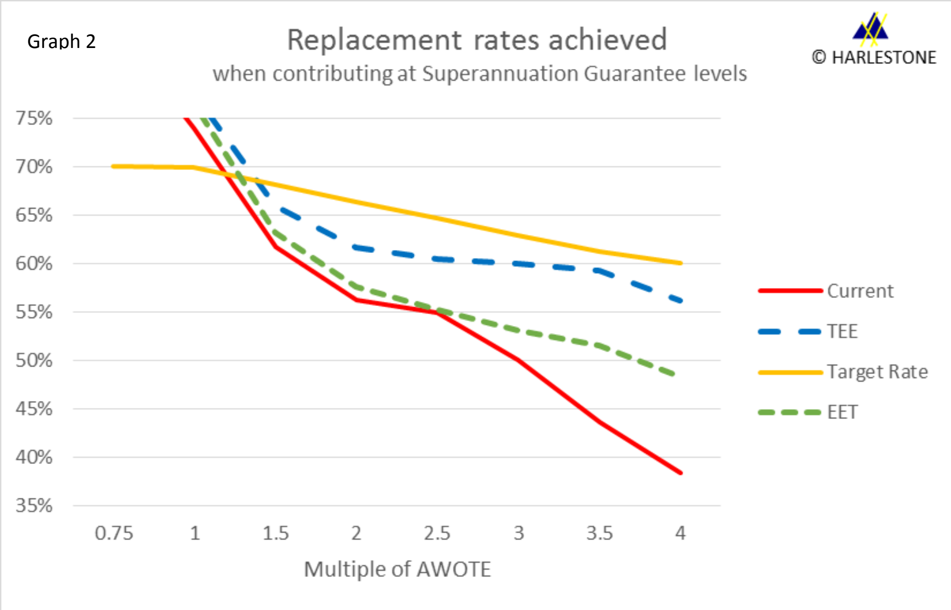
So we also consider a TEE system in which contributions would be progressively taxed but earnings and pensions would be tax free. This is based partly on the proposal by Dr Henry in his "Australia's Future Tax System" Report in 2010 and the subsequent work of Professor Freebairn of Melbourne University.

Compared to the current TTE system, TEE system would have a number of advantages:

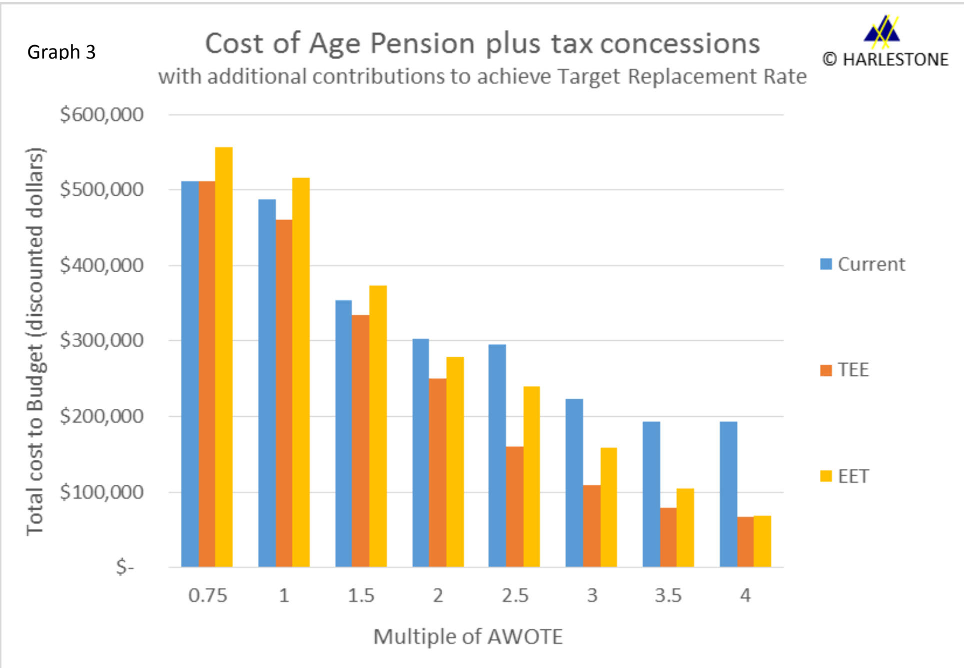
1. It should lead to more Australians achieving adequate superannuation balances;
2. Would be 'fairer' – and perceived to be fairer – across income brackets;
3. Would be simpler and less costly, leading to better net superannuation investment returns;
4. Could be introduced relatively efficiently;
5. Should require less 'grandfathering' than other alternatives; and yet
6. Be tax revenue neutral or possibly positive.

Under this TEE system, contributions are included in an individual's taxable income and thus taxed at progressive income tax rates, with a flat percentage tax rebate.

This system is more effective than the current one at the same cost to the Government. All Australians should get much closer to an acceptable retirement pension rate (referred to as the target Replacement Rate) than under either the current system or an EET system as Graph 2 shows.



Our analysis shows that the TEE alternative would be revenue neutral or possibly revenue positive, but result in more Australians succeeding in having enough super to be independent of the Government funded Age Pension. The following Graph 3 shows the lifetime cost of Age Pension payments plus tax concessions per individual is lower across income groups for both the TEE & EET options compared to the current system.



SMSFOA believes that if a structural change to the taxation of superannuation is to be seriously considered as part of the Tax White Paper process, then a closer examination of the benefits of a TEE system is warranted.

We do not accept that a review of superannuation necessarily implies an increase in taxes on super. A thorough review should consider improvements that can be tax neutral to the Government.

The SMSF Owners' submission also tackles some recurring myths about superannuation including that super tax concessions cost the budget $32 billion and rising. As informed commentators know, and Treasury has confirmed, this figure is both conceptually and mathematically incorrect. It is wrong to suggest the Government could save this money if there were no superannuation tax concessions. The real story is that the cost of not having superannuation would be much higher because more would have to be spent on the Age Pension.

In summary, our message to the Government is: if changes are made to superannuation, make sure they lead to a simpler and more efficient superannuation system designed to ensure more Australians are able to and are encouraged to save for their comfortable retirement.

Contact:

Duncan Fairweather

Executive Director

SMSF Owners' Alliance

dfairweather@smsfoa.org.au

0412 256 200