SUPPLEMENTAL
Submission to the
TAX WHITE PAPER TASK FORCE

24 July 2015

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1. Summary

We thank the Treasurer for the opportunity to make a supplemental submission in relation to Australia's retirement income's policies and their sustainability.

We note the Treasurer hopes that his deadline extension for this purpose would provide opportunities for **achieving stakeholder consensus** on key issues and have therefore made a separate submission to this one jointly with a number of other organisations that outlines our common view of the key issues in relation to retirement income's policy. Apart from SMSF Owners, these organisations are: Australian Shareholders Association, Australian Investors' Association, The Melbourne Superannuation Group, Self-managed Independent Superannuation Funds Association, Independent Contractors Australia and the Australian Chamber of Commerce & Industry.

This group of organisations broadly agree that:

1. The current system is not yet mature and criticism of it and its claimed 'unfairness' have been exaggerated;
2. Increasing taxation of super earnings or otherwise penalising investment success is economically inefficient;
3. Caps on contributions are the best way to limit access to tax concessions but they should be more flexible with perhaps an unused cap carry-forward to assist those with broken work patterns to save;
4. It the tax structure is to be changed, a move to taxing contributions at progressive rates and removing all super earnings taxes could be one way to improve effectiveness of superannuation; but
5. Any changes should not be retrospective nor disadvantage existing savers.

The Treasurer's objective for the Tax Review is to achieve a tax system that is lower, simpler and fairer.

We accept the Government has committed to no unexpected, adverse changes to superannuation, no increase in superannuation taxes nor reduced access to superannuation benefits in retirement. However, the Tax White Paper process provides the opportunity for a re-think on the efficiency and effectiveness of the superannuation system in the longer term. In this context, we have offered in our original submission and further explained in this one, ideas on how the system could be improved to achieve better outcomes at no additional cost to the Budget. The value of the Tax White Paper process is that it allows such ideas to be tested against other views and to challenge the orthodox thinking of policy makers.

Our earlier submission included a detailed comparison of the current system with alternatives and concluded that moving to a "TEE" system that taxes contributions at progressive rates but neither super earnings nor super pensions appeared to be the most effective of the practical alternatives.

[This proposal is essentially as proposed by Dr Henry in his Tax Review, with contributions included in an individual's taxable income with a rebate. However, we found the system became more effective if taxation of superannuation earnings was removed altogether, offset by reducing the rebate proposed by Dr Henry from 20% to 15% so as to result in a neutral budget impact.]

Moving to such a system would meet each of the Treasurer's objectives, in that:

a. **Lower.** The system is more effective, meaning that the superannuation outcomes are better for the same cost to Government, thus leading to a better opportunity to lower taxes;
b. **Simpler.** By removing all taxation within superannuation funds the system is considerably simplified; and
c. **Fairer.** By taxing contributions at a progressive rate, the system is perceived as being fairer.

We have decided to accept the Treasurer's invitation to make an additional submission because we are concerned that some of the analysis and conclusions in our first submission may not have been clear or may not have been adequately addressed.

In particular we are concerned that we may not have adequately addressed some apparently pre-conceived views that:

A. The superannuation system as proposed by Dr Henry would have a higher budgetary cost than the current system;

B. Reducing taxation of superannuation earnings cannot be offset by increasing taxation of contributions to give a neutral budget impact; and that

C. The introduction of progressive taxation of contributions cannot be achieved politically because of a perceived negative impact on too many Australians.

Our analysis does not support these views and we look forward to an open and thorough discussion so that any new ideas can be objectively assessed without any influence from entrenched bias against views that may challenge orthodoxy.

We accept, as a quite reasonable position, that the Government may decide to implement no change to the superannuation system. However, we would then remain concerned that **instability and uncertainty** regarding superannuation could continue, whilst there remain perceptions of 'unfairness' regarding the allocation of tax concessions and therefore uncertainty about what action Governments may take in future.

We present some arguments and relatively simple analysis in the rest of this supplementary submission but would be happy to undertake more thorough analysis if you believe these are ideas worth pursuing. We also present in section 4 a specific proposal to address some of the anomalies regarding the limitations on contributions and provide, in section 5, our views on some other retirement income issues.

In conclusion, we believe that there is an opportunity for the Government to improve the effectiveness of superannuation concurrently with its simplification whilst addressing the perception of unfairness – all without any adverse budget impact.

The improved effectiveness of superannuation under our proposal better allows the Government to fund improvements to the income tax system without any budgetary impact.

2. Why a TEE system could be better that current TTE system

Dr Henry correctly emphasised the significance of the compounding effect of (net) earnings on the effectiveness of superannuation which was his supporting argument for proposing a lowering of the earnings tax rate on super from 15% to 7.5%.

It is not clear to us why he did not take this idea further to propose a full reduction of the earnings tax rate to zero. One can only surmise that he believed that this would either be politically unpalatable or have an adverse budget impact that could not be offset.

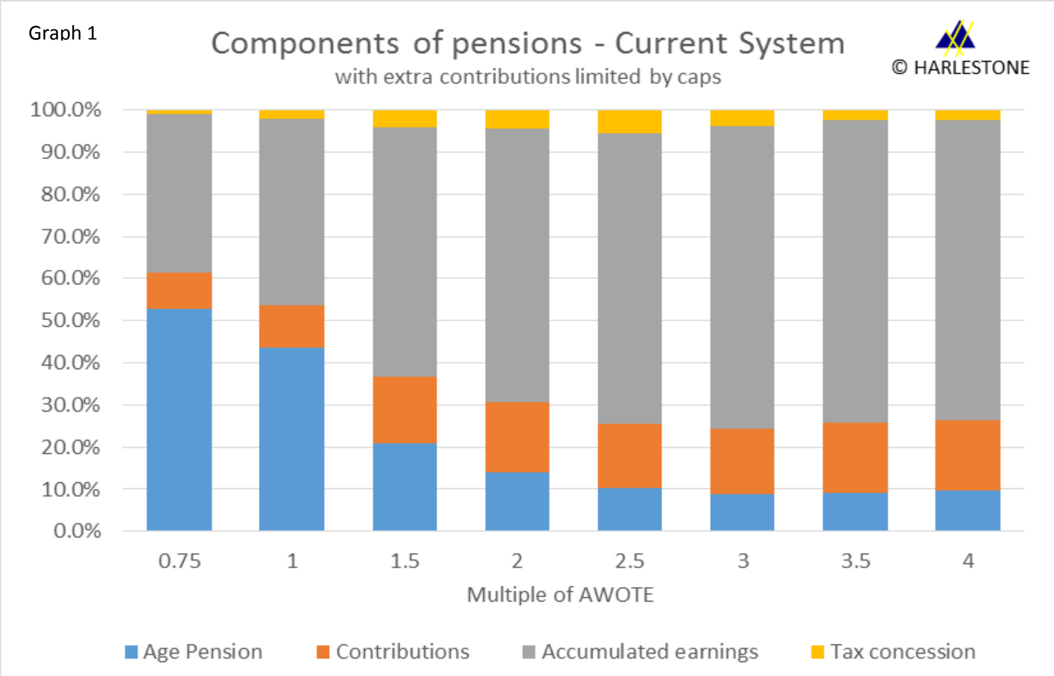
Our analysis however, suggests that, if such an action could be implemented with neutral budget impact, the removal of such earnings taxation would be entirely consistent with the Government's objective of **reducing taxes and simplifying the tax system**.

We understand that there may have been a view that removing earnings tax could not be done whilst keeping a neutral budget impact but we are unconvinced. Our analysis indicates that the earnings tax could be removed and offset by a lower tax rebate on the contributions.

A reason for this possible difference of analysis/opinion could be that the proposal by Dr Henry did not appear to give the same outcome. i.e. any comparison of the tax concessions under Dr Henry's proposal and the current system may not have been comparing 'apples' with 'apples'!

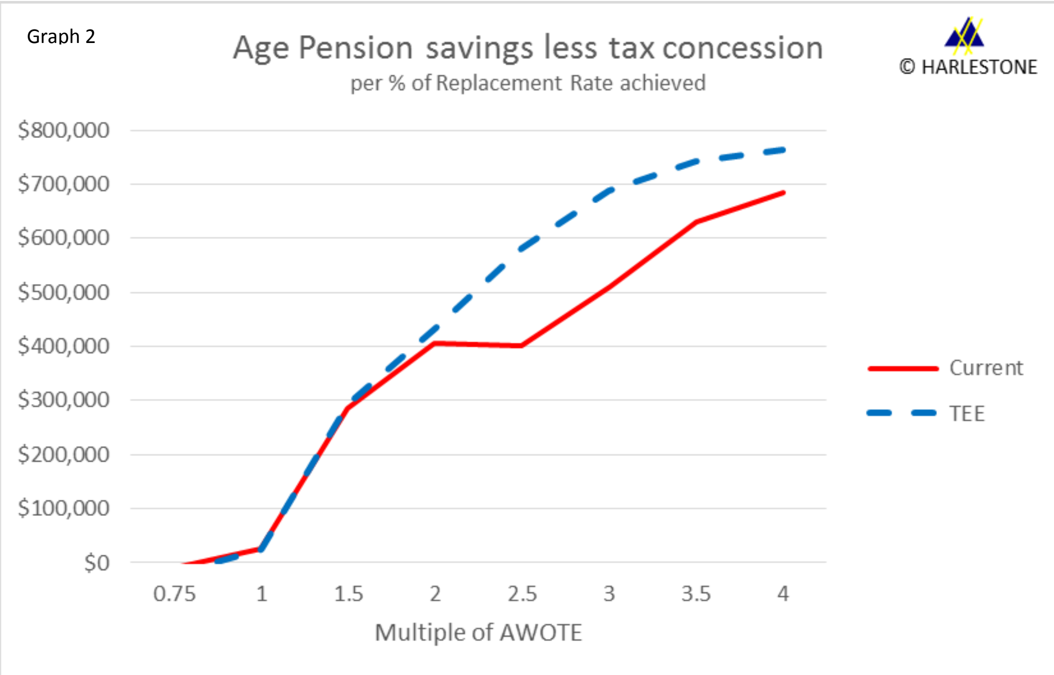
Rather than comparing the impact of his proposed system with the current system using the same superannuation guarantee (SG) rate, a better comparison of the two systems would be to compare the cost/benefit to the Government **of achieving the same outcomes!**

Analysis should also consider the linkage between Age Pension entitlement and superannuation concessions. Tax concessions comprise less than 10% of the funding of pensions whereas an Age Pension is 100% funded by the Government. It should be indisputable that providing well targeted tax concessions to allow and encourage Australians to save so that they become self-sufficient in retirement is a more effective use of Government funds than the Age Pension.



The important lessons from Graph 1 is are how small the tax concessions are (much less than 10% and far smaller than the cost of Age Pensions) and how large and significant are the accumulated earnings.

Our analysis shows that the savings in Age Pension as a result of superannuation exceed the tax concessions for everyone on a range of incomes. To compare the systems therefore, we consider the budget **savings** achieved that allow each Australian to reach a certain pension level.



Graph 2 illustrates how the budget savings **increase** with income and are **higher** under the TEE system than the current system to achieve the same Replacement Rate.

3. Impact on Australian taxpayers

The other matter that perhaps needs further explanation is labelled "C" in the summary above. That is, there may be concern that the introduction of progressive taxation of contributions cannot be achieved politically because of a perceived negative impact on too many Australians.

We addressed this briefly in our earlier submission. Because our existing income tax system is already so progressive, we believe that a progressive taxation of superannuation contributions should not be introduced without improvements ('flattening') of our income tax system.

We then intended to wait until the Green Paper in the hope that our proposal would be one of those on which the Task Force would seek input. We have some ideas about how to implement the proposal but are sure there are many other and better ideas that others may develop if encouraged to do so.

However, it may be helpful for us to share our preliminary work on assessing the impact of introducing our TEE proposal.

One preliminary idea is that:

A. Initially, the progressive taxation of contributions be introduced by including contributions in an individual's taxable income with a 25% rebate, but with the SG level reduced to 8%, removing the super fund's taxation of contributions but retaining the taxation of superannuation earnings in accumulation phase;

B. At the time when the SG level was to have increased to 12% under the current system, the rebate falls to 15% and the taxation rate of superannuation earnings reduces down to zero.

Given that the 15% tax on contributions would be removed, the 8% SG level proposed under the TEE system provides the same funds (net of contribution tax in the fund) into super as the 9.5% level under the current system. In the short term, the impact on individuals is reduced if the sums that were to have been paid into super under current system are paid to them directly as salary. Whilst this would work for those whose total contractual remuneration includes superannuation contributions, for others such as those on an award, there may need to be some mechanism to ensure this occurs. In the extreme, if awards cannot be changed, then the super funds could be obliged to pay back to an individual the amount of contribution above the new 8% level if so requested by the individual. This is similar to the way the surcharge is currently administered.

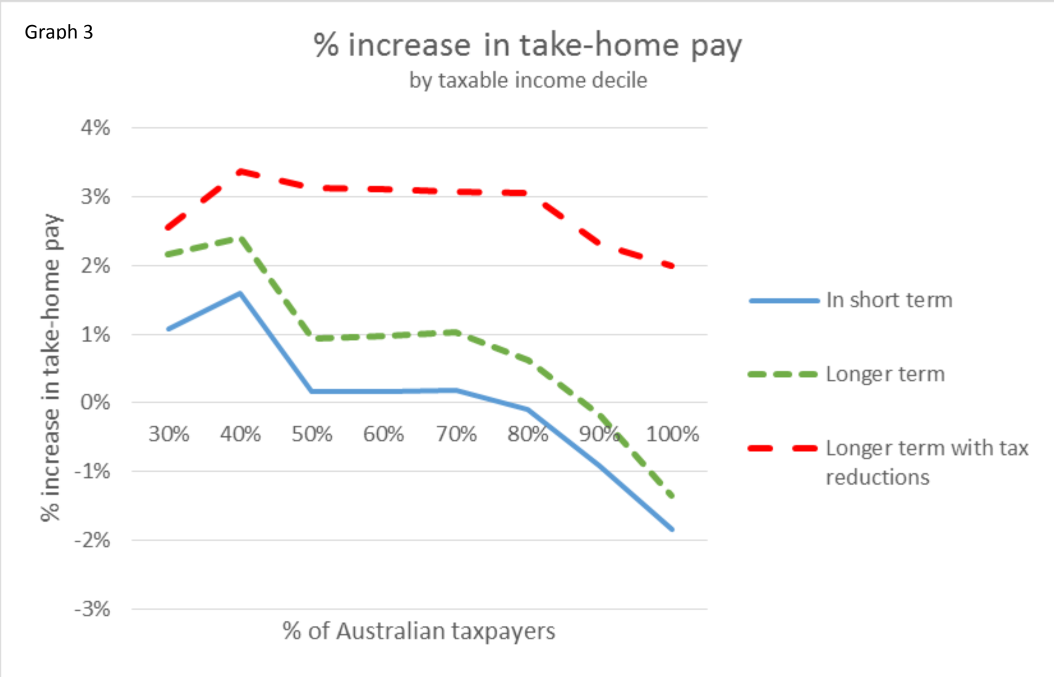
With a 25% rebate, our preliminary analysis suggest that this would have a slightly positive revenue impact.

In the longer term, if one assumes remuneration packages are determined by the market-place based upon the cost to employer, then wages paid are higher if the SG level is only 8% vs a planned 12%.

The following Graph 3 shows the percentage improvement in after tax income for Australians at each decile of taxable income. Our brief analysis indicates that 70- 75% of Australians would be better off with the implementation of this system.

In the long term our estimate is that this proposal would be budget positive by about $14 billion per annum in today's dollars. If, therefore, the final implementation of this system was introduced concurrently with, say, a 1% reduction in all income tax rates and an increase in the income tax thresholds (apart from the first one) of, say, 10%, then **all Australians should be better off and the Government impact may still be slightly positive.**

The following graph therefore also shows the impact on Australian taxpayers if such income tax reductions are implemented.



4. Addressing issues with current limitations on contributions

In our original submission we referred to two issues regarding limitations on tax-concessional contributions.

1. That limits on tax-concessional contributions are specified as an annual cap; and
2. That there is a total prohibition on personal contributions for those over 75.

The first issue disadvantages those with broken work patterns and several organisation (including ours) have proposed a system of rolling caps similar to the caps on non-concessional contributions.

The second issue is growing in significance as society tries to encourage more work-force participation from older persons. We have previously proposed that a system of rolling caps or lifetime caps could be implemented.

One alternative possibility which addresses both issues could be as follows:

a. Allow carry forward of unused annual cap/allowances;
b. Cease the annual allowance at a particular age (say the Age Pension commencement age); but allow carry forward of unused contribution allowance beyond that age.

This helps both groups disadvantaged by the two issues but provides some ‘sunset’ on the use of tax concessional contributions.

5. Other issues raised in Treasurer's media release of 16 June

In relation to the Treasurer's media release of 16 June 2015 we offer the following brief comments.

Voluntary contributions

The Treasurer noted that the 'third component' of Australia's superannuation system is voluntary savings which include voluntary superannuation contributions, the purchase of owner-occupied housing and other private savings. He also noted that the purpose of superannuation tax concessions is to encourage people to lock away savings to help fund their future retirement.

We have suggested in previous submissions that, to meet the objectives set by the Government, voluntary contribution caps should be increased to at least the level set by the previous Coalition Government ($50,000/$100,000) but since substantially reduced. The higher level may not be necessary in the longer term if our idea in section 4 of allowing unused cap to be carried forward is implemented.

Retirement income stream products

We agree with the Financial System Inquiry Report that there is potential for further development of the market for retirement income stream products, such as annuities.

We also agree that superannuation fund trustees should provide members with a 'pre-select' option. However, this is not necessary in the case of self-managed funds where the trustees and beneficiary members are the same. To require a 'pre-select' option within self-managed funds would be an unnecessary compliance cost and there should be no compulsion for SMSF trustee to invest in such products.

Release of home equity

Downsizing from the family home is a prospect faced by many people in their retirement. Reverse mortgage or other 'equity release' products should also be encouraged and facilitated.

We believe it would be consistent with the purpose of superannuation for them to be able to transfer any such equity thus released that is surplus to their immediate requirements into their superannuation fund tax free (as the family home is not taxed).

Minimum withdrawals

While minimum annual withdrawals are consistent with the purpose of superannuation, some retired people are concerned that their savings may not last long enough or that they will not have enough in their fund to meet high health and care costs in the latter stages of life or for unexpected expenses. This concern is amplified at a time of very low interest rates, less reliable share market returns and general economic uncertainty. People are living longer and may also be concerned about making their retirement savings last longer.

The Treasury review of the minimum withdrawal rates should take these intangible factors into account and ensure that the withdrawal schedule will leave people with enough in their superannuation funds to last for longer than the expected lifespan, since half of Australians will live longer than the median lifespan. This will help to ensure that older Australians with superannuation do not become reliant on the Age Pension or a burden on the public health system towards the end of their lives.

Lump sum withdrawals

It is unlikely that people who have made a long-term commitment to build sufficient retirement savings to maintain financial independence in retirement will 'blow the lot' on a spending spree when they retire. However, where people do not have sufficient savings to last throughout their retirement and will have to rely on the Age Pension, it is rational for them to withdraw their superannuation and spend it before claiming the Age Pension.

We have suggested in previous submissions that lump sum withdrawals continue to be allowed provided they do not reduce the fund assets below the point where they can generate income higher than the Age Pension by a reasonable factor.