SUBMISSION IN RESPONSE TO THE TAX DISCUSSION PAPER

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COTA Australia

June 2015

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INTRODUCTION

COTA Australia is the national policy organisation of the eight State and Territory Councils on the Ageing (COTA) in NSW, Queensland, Tasmania, South Australia, Victoria, Western Australia, ACT and the Northern Territory.

COTA Australia's focus on national policy issues is from the perspective of older people as citizens and consumers and it seeks to promote, improve and protect the circumstances and wellbeing of older people in Australia. Our submissions incorporate the views of our members and broader constituencies developed through various consultation mechanisms.

COTA welcomes the opportunity to make a brief response to the Tax Discussion Paper and looks forward to engaging in the broader consultation process on taxation reform.

In this submission COTA proposes a number of principles to underpin the tax system in general and in regard to taxation of savings in particular; and identifies some aspects of the tax system that have the greatest impact on Australians in older age.

While COTA sees value in contributing to the Tax White Paper process, we wish to stipulate that we do not see the review of the tax system by itself as an adequate platform for the examination and necessary realignment of the retirement incomes system. This is reinforced for us by the general absence of broader non-economic considerations in the Discussion Paper and the limited recognition of the connection between tax policy and other areas of public policy.

COTA has lead the way over the past year in calling for a dedicated independent Retirement Incomes Review that looks in an integrated way at taxation, transfer payments, superannuation, mature employment, later life housing, and financing aged care. We have over the year been joined in that call by a growing number of stakeholders including business peaks, superannuation peaks, community organisations, academics and policy think tanks. We firmly maintain that such a review is required to understand the complexity of the retirement incomes system and to find ways to strengthen its adequacy, fairness and sustainability into the future.

An important driver of our argument for an integrated Retirement Incomes Review is to ensure that a long-term view is built more firmly into retirement incomes policies. We hold the same position in regard to the Tax White Paper process. The review of taxation arrangements should not be undertaken with a short term agenda of 'Budget repair'. It should take a long term view, with a key goal of encouraging all citizens to save for their future, in the context of an older and longer-lived population.

1. KEY PRINCIPLES

1.1 A set of principles for effective taxation system design

COTA proposes that the following principles should underpin the Australian taxation system:

1. It should operate with **fairness** across the diversity of the population;
2. It should generate **adequate revenue** to properly meet societal needs that require public funding;
3. It should be as **simple and transparent** in design as possible;
4. It should contain incentives to promote **productivity and creativity**;
5. It should **promote saving** for periods of non-earning, including "retirement";
6. It should be designed to be as stable as possible over the **long term**, but with the capacity to adapt to circumstances;
7. It should be **consistent** with and **support** other public policy goals.

All of these principles need to be applied in the design of a taxation system. They are interdependent and if they are all applied they will work effectively in a synergistic way. If some are not followed or are weakly applied in the system's design then the others will not operate as effectively.

1.2 Fairness and adequacy

COTA believes that amongst the above set of principles two key principles must absolutely underpin an effective Australian taxation system. These are the principles of fairness and of adequacy.

A tax system is fair if it treats people who are in a similar situation in a similar way, and treats people in different situations in ways that take reasonable and proportional account of these differences.

A tax system is unfair if its distributional effect is to widen social and economic difference, allowing or resulting in greater vulnerability and deprivation at one end and facilitating unreasonable degrees of privilege at the other.

In addition both the reality and perception of unfairness in any government system, including taxation, is corrosive of social cohesion and will have negative impacts on the motivation of individuals, population cohorts and societal groups.

Adequacy is also essential to the effectiveness of a taxation system. If taxation revenues are insufficient for the purposes that the population regards as essential and appropriate roles and functions of government then this will also undermine confidence in government and therefore in the taxation system. It also increases conflict between different sectors of the population as they vie for shares of an inadequate revenue base.

COTA considers progressive taxation as the key driver of fairness in the taxation system, embedding the idea of 'ability to pay' as fundamental, while taking into account proportionality and the principles regarding incentives. Therefore whether the current tax review results in a 'root and branch' overhaul or makes targeted changes, the system should become no less progressive overall than it is now. Rather, the progressive nature of some current tax policies should be strengthened and the regressive approach that is built into some arrangements should be corrected.

Some current taxation arrangements disproportionately benefit higher income earners over middle and lower income earners. While there are growing numbers of older Australians with higher levels of assets and income than in the past, as a group older Australians tend to be among the lower income brackets of the population and most will continue to be so well into the future.

Such taxation arrangements also limit Government revenue generation, in turn reducing the Government's ability to fund transfer payments to and services for those most in need, including many older Australians. One of the most prominent of these regressive arrangements is tax concessions on superannuation (see later).

An overall suggestion to increase fairness in the tax system is to avoid devices, arrangements, concessions or deductions which undermine the progressive taxation regime and also make the system complex and opaque to most taxpayers, rather than simple and transparent. If a mechanism is needed as an incentive or to increase fairness, primary consideration should be given to transparent and targeted transfers or adjustments to the rates and thresholds of direct taxation. Other arrangements should only be adopted on the basis of clear evidence that the outcomes in the short and longer term will both achieve their purpose and not compromise the basic design of the system.

2. SAVINGS, TAX AND OLDER AUSTRALIANS

2.1 Principles

COTA proposes the following key principles to underpin the goals and operation of the taxation system in regard to retirement savings:

a. The tax system should contribute to **optimizing the adequacy** of retirement incomes;
b. The tax treatment of savings, including superannuation, should **exhibit fairness**;
c. The tax arrangements to support retirement income must be **fiscally sustainable**;
d. Along with other elements of the retirement income system the tax arrangements

should **contribute to certainty**;

e. The arrangements should be as **simple and transparent** in design as possible.

Obviously the tax system has an important role in promoting, enabling and supporting a retirement incomes policy, but it is only one part of that system. This tax review cannot achieve all that needs to be done in fine tuning Australia's retirement income system so that it produces greater adequacy in a fairer and more sustainable way. Only an integrated Retirement Incomes Review with strong stakeholder engagement will achieve that.

2.2 Tax treatment of retirement savings

The tax treatment of savings for and in retirement is predominantly about tax arrangements around superannuation which include:

- A flat tax rate of 15% on contributions to superannuation funds up to an annual cap
- A flat tax rate of 15% on earnings in superannuation funds
- Exemption from income tax on pension income streams from superannuation

However before discussing these it is important to note that savings for retirement can and do take other forms. A not insignificant number of people use property investment for this purpose, utilizing negative gearing. Small and family businesses may not have superannuation as all their resources are invested in the business until they sell it to retire. People have other forms of investment that is not held by an SMSF and the different taxation treatments of such savings are a cause of concern and sometimes confusion to affected retirees.

The design of tax arrangements related to savings through the superannuation system should be consistent with and support the purpose of the superannuation system. COTA supports the Financial Systems Inquiry proposal that there should be a clear legislative purpose for superannuation along the lines of it being to provide income in retirement in substitute for or to supplement the age pension.

There has been much public and private discussion and debate about how the superannuation system should be improved. Many submissions to this Discussion Paper advance such proposals. COTA has argued for a Retirement Incomes Review that will look at all such proposals and engage stakeholders in an iterative consultative process that we believe would result in substantial level of consensus across the retirement incomes sector which would create the potential for cross-partisan agreement on significant change.

We seek indulgence to point out that we have already demonstrated the value of such an approach with the achievement of aged care reform under the Gillard government.

For that reason COTA has resisted advocating particular proposals so that our push for a Retirement Incomes Review is not seen as supporting any stakeholder agenda. Rather our objective is to be the catalyst for a process that will produce the best possible outcome at this juncture. That will not be achieved if pensions and superannuation remain major political footballs. Our colleagues in National Seniors Australia agree, saying in their submission on this Discussion Paper that:

> "*National Seniors considers it crucial that any proposal for change to the taxation treatment of superannuation savings be considered in the broader context of Australia's retirement incomes policy, including the treatment of financial and other assets when determining eligibility for the Age Pension… It is therefore disappointing that both the Government and the Opposition have announced policy positions that fail the first of these tests, with each focusing on only one aspect of the retirement income system. (p12)*

COTA is on the record repeatedly arguing that current superannuation tax treatments are neither fair nor effective in providing the conditions for a sustainable retirement incomes system. Even taking account of the safety net effect of the age pension and other measures of income support, it is clear that current tax arrangements are unfair in the way they treat individual differences in both circumstances and income.

Current arrangements overwhelmingly benefit the highest income earners, with the bulk of the concessions going to the top 20% of the income earners. As the Challenger submission notes (p5):

> "*In 2012 Phil Gallagher PSM, then the Manager of Treasury's Retirement and Intergenerational Modelling Unit, made a presentation to the UNSW Colloquium of Superannuation Researchers titled; The Distribution of Government Support for Retirement Income – Point-in-Time and Lifecycle Estimates. (See Appendix A). The presentation showed that the top two deciles combined receive more than 57.2% of superannuation tax concessions while the bottom four deciles combined receive 6.8%."*

If the generally accepted purpose of superannuation tax concessions is encouragement to self-provision for retirement rather than reliance on the public pension then clearly this very top group of income earners does not need public assistance or incentives to save for retirement. There is little likelihood that this group will ever draw on the public pension and it is now widely acknowledged that tax arrangements make the superannuation system an attractive place for the very well-off to park personal wealth and draw a tax-free income. This is far cry from the intended public policy outcomes, and has been acknowledged broadly by stakeholders including the 2014 report of the Financial Systems Inquiry.

A more effective tax policy would seem to be to boost the retirement savings of lower income people directly. There are clearly savings constraints on lower income people. COTA views the tax system as capable of offering additional support to this group to save for a more adequately funded retirement. The current Superannuation Co-Contribution is one limited example of this, but COTA believes that more should be done in this regard.

We note that there is considerable agreement that the recommendations in the Final Report of the Review of Australia's Future Tax System to reshape the tax concessions regime provide constructive food for thought; and there is similarly considerable agreement that consideration should be given to capping the amount of super that would attract concessional tax treatment. Again our colleagues at National Seniors Australia concur (p13):

> *"To address concerns that tax concessions provided to high income earners are excessive, consideration could be given to the Henry tax review recommendation that superannuation contributions be taxed as income at normal marginal tax rates, but with flat-rate refundable tax offset. This would increase the effective tax rate on contributions for high income earners while subsidising contributions of low income earners. Further, if it is agreed that the purpose of superannuation is to provide an adequate income in consideration should be given to limiting access to tax concessions once an individual has accumulated sufficient superannuation to enjoy a reasonably high standard of living in retirement."*

The issue of broken work careers is also not addressed by the current system. While we agree with annual/triennial caps on additional contribution for people with unbroken careers, consideration needs to be given to introducing a degree of flexibility to allow those with broken careers (still most often women) to 'make up' list ground in superannuation savings.

Another example of the sort of broader thinking that could be explored relates to the family home. The family home receives special treatment in both the taxation and transfer systems. We could consider the option for people of pension age to be eligible to voluntarily transfer excess capital (to a specified limit) from 'resizing' the family home into a superannuation account, to be drawn down on the same tax terms as other superannuation. COTA recognizes that while this is an interesting idea with potential, clearly it would need close scrutiny for unintended consequences.

This brings us back to COTA's call for an integrated Retirement Incomes Review which could clarify the purpose and future operation of the retirement incomes system.

2.3 Taxes, transfers, employment earnings and older Australians

The interaction between the tax system and the transfer system is also an area that requires close examination.

COTA believes that there is scope to use lower taxation for targeted outcomes such as increasing workforce participation for particular groups; for example, those transitioning from government income support to work, including older Australians. This could be achieved by raising the tax free threshold or revising effective marginal tax rates. Once again, we support careful modelling and consideration of the impacts of potential changes such as this, to be sure that they work as intended and increase fairness in the system overall.

COTA strongly supported the Age Pension Work Bonus scheme, an incentive for age pensioners to remain active in the workforce and keep more of their income or work for short periods with little or no effect on their pension. COTA supports mechanisms such as this which encourage continued part time workforce participation.

3. HOUSING, TAX AND OLDER AUSTRALIANS

Access to affordable and appropriate housing is a key issue for older people, influencing their wellbeing, their capacity to continue to contribute to their family and community, and their choices about support and care as they age. Housing is a key component of the cost of living for older people, particularly for those who do not own their own homes.

For those who do own their home, ‘right sizing’ – often but not always by moving to a smaller and/or more appropriately designed residence or garden – allows older people to adapt to their life needs as they change. COTA argues for the removal of taxes, such as stamp duties, which create barriers for older Australians taking these steps when they need. Where stamp duty is maintained, COTA proposes that those on low incomes, who are selling their ‘family home’ and buying another to live in, should be exempt. We recognise that these are State taxes but their removal requires Federal and State cooperation.

COTA acknowledges that appropriate housing availability (supply) and affordability are also key drivers in ‘right sizing’ decisions. The tax system plays a role in these issues through, among other mechanisms, capital gains tax and negative gearing arrangements.

Affordable, appropriate housing supply is a crucial issue for many older Australians either needing to rent on the private market, or wishing to sell and move to a more appropriate home. COTA agrees with organisations such as ACOSS that negative gearing of rental properties as currently construed has a propensity to encourage speculation, boost prices, most benefits the top 20 per cent of income earning households and makes a minimal contribution to increasing housing supply.

We note that despite the Henry Tax Review proposals and calls from a broad range of stakeholders there still has been no change to these arrangements. COTA supports the call by Anglicare Australia for the government to redirect negative gearing more towards the supply of affordable housing and the improvement of its quality and to consider restricting tax deductions to the costs of the housing rather than other income.

4. GST AND INDIRECT TAXES

Many current older Australians are not in paid employment, do not have large superannuation balances or incomes, and have their only or principal wealth invested in the family home. Therefore the GST is their most significant point of regular transparent engagement with the tax system. However they of course contribute - through their purchases - to the income taxes of employees of companies from which they purchase, to the company taxes of those companies, and other incidental taxes.

COTA is basically opposed to an increase in the rate or the broadening of the base of GST because consumption taxes have a disproportionately negative impact on people with fixed and low incomes, such as many older Australians. However, we agree that tax reform requires all arrangements to be considered with an open mind and reference to quality research and modelling on the impacts of proposed changes.

In this context, COTA holds a strong view that if there is any increase in or broadening of the GST there must be adequate compensatory arrangements in place to support low income people, either through offsets in the tax system or transfer payments. Further, it would be appropriate to fund these supports directly from increased GST revenue.

When the GST was introduced COTA negotiated such compensations but at the time we believed these were inadequate and we still hold that view. We recognize that the current government has retained the previous government's energy supplement which is a positive impact on the value of the age pension in the short term. However we do not believe this is a sound long term approach to pension adequacy.

COTA Australia
8 June 2015