G A Cossar & Co Pty Ltd

ESTABLISHED 1994 **ABN 74 065 655 021**

PO Box 445, Rye, Victoria 3941
Telephone 5985 2295 Fax 5985 2189

Geoff Cossar
B.Ec., F.A.I.B.F
Cert. of Bus. Studies
Cert. of Inv. & Fin Planning
gcossa@yahoo.com.au

5 May 2015

Tax White Paper Task Force
The Treasury
Langton Crescent
PARKES, A.C.T. 2600

Dear Sirs,

With regard to the Taxation Discussion Paper, we would like to submit the undermentioned remarks which relate to your Discussion Question Number 22 concerning the fairness of taxation arrangements in relation to superannuation.

Over the past 25 years or so, generous taxation incentives have been made available to older Australians to encourage them to voluntarily boost their superannuation savings beyond levels which would have occurred if only compulsory contributions were credited to their superannuation accounts.

Perversely, it is now apparent that, far from achieving the objective of encouraging older Australians on middle and lower incomes to voluntarily boost their superannuation savings (and thus rely to a lesser extent on the Aged Pension when they retire), the majority of the Commonwealths generous tax concessions for superannuation have gone to wealthier Australians on higher incomes who in all likelihood would never meet the means test requirements to qualify for an Aged Pension.

That so much public money has been so misdirected for so long is an indictment on all the politicians who've sat in the Federal Parliament over the past two decades, and on all the Public Servants who've provided them with advice.

As a simple basis for conducting policy in the area of superannuation, it appears patently obvious that in granting or continuing to offer any type of tax concession, the Commonwealth should expect, and should be able to demonstrate, that a dollar spent on a tax concession today will be more than offset, in net present value terms, by a saving to the Federal Budget in future from a reduced level of Aged Pension payments.

In seeking to achieve a far better outcome than Australia is currently achieving from Commonwealth outlays spent in this area, we strongly recommend the introduction of a progressive taxation scheme for contributions made to, and income earned on, superannuation savings during the accumulation phase.

We also strongly recommend that a progressive taxation scheme be introduced for those receiving a pension sourced from their superannuation savings.

We are concerned that whilst an enormous level of payments and concessions are made each year by the Commonwealth to encourage Australians to boost their superannuation savings, and thereby reduce or eliminate their future dependence upon the Aged Pension, the majority of these Commonwealth outlays continue to flow to wealthier Australians who are never likely to be Aged Pension recipients.

We consider that the introduction of a progressive taxation basis within the superannuation area will help alleviate these concerns. Such a regime could considerably boost the retirement savings of lower paid workers whilst, at the same time, limiting the excessive benefits currently being gained by those on very high incomes or with very high superannuation savings.

....

When the Commonwealth of Australia came into existence on 1 January 1901, its citizens enjoyed one of the highest per capita income levels in the world. Even so, Australians were conscious that some of their fellow citizens, once they'd finished working, didn't have sufficient savings to be able support themselves.

In mid 1908, the Commonwealth legislated to introduce means tested Age Pensions for all Australians over 65 year of age. At the time, life expectancy for an Australian male was 53.8 years and for an Australian female 57.5 years.

Some 80 years later, Australians still enjoyed one of the highest per capita income levels in the world but had also come to assume their life expectancy would be nearly 25 years longer than Australians at Federation. Even so, Australian males were still entitled to an Age Pension once they reached 65 and Australian females entitled once they reached 60 years of age (subject to means test restrictions).

However, it had become apparent that the nation's capacity to fund these types of payments to an increasingly higher percentage of its older population, from the general revenues of the Commonwealth, was unsustainable.

The remedy developed, and legislated in the early 1990's, was to introduce compulsory superannuation. It was hoped that, over time, savings built up through compulsory superannuation contributions, combined with voluntary superannuation contributions (which individuals would be encouraged to make through generous taxation incentives), would significantly reduce the numbers relying on the Aged Pension. It was assumed that the Aged Pension entitlement would continue but more likely as just a "safety net" because most Australians would ultimately have sufficient savings within their superannuation accounts to support themselves in retirement.

Notwithstanding the benefits the compulsory superannuation regime would provide to retirees in the longer term (not to mention the benefit to the Federal Budget), in the near-term, savings through compulsory superannuation were considered unlikely to be able provide an adequate retirement income for older workers (particularly those who had only begun to accumulate superannuation from the early 1990's). Accordingly, over the past 25 years or so, generous taxation incentives have been made available to Australians to encourage them to voluntarily boost their superannuation savings beyond levels which would have occurred if only compulsory contributions were credited to their superannuation accounts.

Perversely, it is now apparent that, far from achieving the objective of encouraging Australians on middle and lower incomes to voluntarily boost their superannuation savings (and thus rely to a lesser extent on the Aged Pension when they retire), the majority of the Commonwealths generous tax concessions for superannuation have gone to wealthier Australians on higher incomes who in all likelihood would never meet the means test requirements to qualify for an Aged Pension.

In other words, despite an objective of encouraging more and more Australians away from reliance on an Aged Pension by giving them a tax incentive to boost their superannuation savings, the majority of the Commonwealth's outlays in this area have effectively been paid to those who were never, ever going to be recipients of an Aged Pension.

We would argue that, in seeking to reduce the number of Australians who will rely on an Aged Pension, paying vast amounts of Commonwealth taxation concessions to Australians who are never, ever likely to qualify for an Aged Pension isn't just a little unfair and a little misdirected.

It's downright stupid.

That so much public money has been so misdirected for so long is an indictment on all politicians who've sat in the Federal Parliament over the past two decades, and upon the Public Servants who provide them with advice.

As a simple basis for conducting policy in the area of superannuation, it appears patently obvious that in granting or continuing to offer any type of tax concession, the Commonwealth should expect, and should be able to demonstrate, that a dollar spent on a tax concession today will be more than offset, in net present value terms, by a saving to the Federal Budget in future from a reduced level of Aged Pension payments.

No one analyzing the benefits Australia is gaining from the enormous level of tax concessions made in the area of superannuation, skewed heavily as they are towards wealthier Australians, would argue that the system is working efficiently. No one would argue the system is achieving its objective as set out in the previous paragraph.

Whilst it may be slightly outside the role of the White Paper Task Force, we believe it is nonetheless appropriate that you call upon the Commonwealth Government to initiate a thorough review of all Commonwealth outlays in the superannuation environment; with particular focus placed upon quantifying the extent of benefits and concessions paid or provided to those Australians whose higher wealth or higher incomes make it unlikely that they would ever qualify to be a recipient of the Aged Pension.

In seeking to achieve a far better outcome than Australia is currently achieving from Commonwealth outlays spent in this area, we strongly recommend the introduction of a progressive taxation scheme for contributions made to, and income earned on, superannuation savings.

We submit that it would more efficiently focus Commonwealth spending within the superannuation environment towards reducing the numbers of Australians likely to be dependent on an Aged Pension in the future.

Furthermore, we would submit that a progressive taxation scheme affecting income earned on superannuation savings would be considered by Australians to produce a much fairer outcome; we have no doubt that all Australians would agree that those with the lowest superannuation balances, not those holding superannuation accounts with multi-million dollar balances, should be the major recipients of government concessions or expenditures in this area.

In supporting the introduction of a progressive taxation scheme for income earned on superannuation savings, we are very conscious of the need to be fair to all those with superannuation savings currently in the accumulation phase.

However, we are conscious that the overriding objective should be to improve the effectiveness of taxation concessions made available by the Commonwealth – concessions made available now should more than pay for themselves in terms of reduced Aged Pension outlays in future.

As an example of how the introduction of a progressive taxation system on superannuation savings could operate, we conducted financial modeling to illustrate the outcomes which could be achieved.

We modeled an individual who commenced work at 20 year of age, worked for 40 years and just made compulsory superannuation contributions over their working life.

Under current taxation arrangements as they relate to superannuation savings, an individual on a very low income (or perhaps an income from mainly part-time work), which we assumed as equal to $30,000 per annum gross in today's dollars, would cease work at age 60 with accumulated superannuation savings of about 3.4 times the level of their gross salary at that time.

In looking to compare what may have happened if a progressive taxation policy had been in force, we modeled a scenario where the first $20,000 of superannuation earnings and contributions each year were tax free and the next $80,000 of superannuation earnings and contributions attracted a taxation rate of 15% (as they do now). We assumed the tax free threshold and the 15% tax band rose each year in line with assumed inflation.

The result for the individual described above was that their final superannuation balance was some 58% higher and the accumulated balance of their superannuation savings represented about 5.4 times the level of their gross salary when they finished working.

On the basis described above, we also modeled the comparative outcomes for an individual earning $50,000 per annum in today's dollars over the course of their assumed 40 year working life. We also introduced another tier of taxation – 30% taxation payable on earnings and contributions over $100,000 per annum in today's dollars.

The likely result for this individual under the current taxation regime applicable to superannuation savings is that they would complete their working life at age 60 with a superannuation balance around 3.4 times the level of their final salary at the time.

Under the progressive taxation basis described above, the individual concerned would finish their working life with an accumulated superannuation balance approximately 48% higher. The accumulated balance in their superannuation account would represent about 5 times the level of their final salary.

For individuals who spend their lives in relatively lower paid employment, a progressive taxation system within the superannuation savings environment, as illustrated by the above two examples, could provide a significant boost to the level of their final accumulated superannuation savings.

Additionally, by the use of an upper tier of taxation on superannuation earnings and contributions, the significant amount of tax concessions now flowing to higher income recipients would be curtailed (the extent of this curtailment would depend upon the upper taxation rate adopted and the earnings/contribution level at which it becomes applicable).

The Commonwealth could actually introduce such a taxation initiative and make it cost neutral to the Federal Budget by striking an upper tax rate and an upper tax threshold which would deliver sufficient additional tax revenues from high income earners, or individuals with very high superannuation savings, to offset the cost of additional tax concessions made to lower income earners.

As indicated in the two examples above, individuals on a salary of $30,000 and $50,000 gross per annum in today's dollars are considerably better off at retirement under the progressive tax rates we modeled.

However, notwithstanding that a 30% upper taxation rate has been introduced in our example (when the current regime carries a maximum taxation rate of 15%), our modeling shows that individuals earning considerably more than $50,000 gross per annum in today's dollars over their working lives will not be worse off than they would be under the current regime. Other than those on considerable salary levels (individuals who would not be expected to finish their working lives and be eligible for an Aged Pension in any event), the introduction of a tax free threshold generally offsets much if not all of the additional tax imposed in the upper 30% bracket.

As well as introducing a progressive taxation regime for the way the superannuation savings of Australians are to be taxed in the accumulation phase, we would also recommend a progressive taxation basis be applied to Australians who are drawing pension payments from their superannuation savings.

Compulsory superannuation is meant to be a means whereby Australians are able to save enough money over their working lives to enable their superannuation savings to provide them with a pension income to support them in retirement and not have the need to access an Aged Pension to do so.

However, we believe it makes no sense whatsoever for the Commonwealth to provide all Australians drawing a pension from their superannuation savings with an unlimited tax free entitlement on those drawings.

We would argue that in paying income tax, it should not matter whether an individual's income is derived from personal exertion, from investment returns on their wealth or from drawings from their superannuation savings.

We accept that in drawing down a pension from their superannuation savings, the individual is, in effect, drawing down both savings they have invested into superannuation themselves as well as the accrued earnings on those savings over time. Accordingly, they should not have to pay income tax on that proportion of their superannuation pension drawings represented by their historical savings contribution.

Despite this aspect adding a little complexity, we do not believe it should be "simplified" by allowing an unlimited tax free threshold for any income paid which is sourced from superannuation savings.

As we have tried to articulate, we are concerned that current taxation arrangements within the superannuation environment represent a huge waste of taxpayer money.

We are concerned that whilst an enormous level of payments and concessions are made each year by the Commonwealth to encourage Australians to boost their superannuation savings, and thereby reduce or eliminate their future dependence upon the Aged Pension, the majority of these Commonwealth outlays are flowing to wealthier Australians who are never likely to be Aged Pension recipients.

We consider that the introduction of a progressive taxation basis within the superannuation area will help alleviate these concerns. Such a regime could considerably boost the retirement savings of lower paid workers whilst at the same time, limiting the excessive benefits currently being gained by those with very high incomes or very high superannuation savings.

Yours Faithfully

Geoff Cossar
Director