TAX WHITE PAPER

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Note: Information, assumptions and analysis should not be assumed to be accurate, as it is only provided for concept appreciation.

SUMMARY

Question 6 (page 2)

Tax Scale – Deductions and Super Contributions

- Deductions and Super Contributions from the bottom up.
    - All income levels receive same rate of deductions on losses and super contributions
- Flatter Tax scale (Min 10% to Max 40%)

Question 21 (page 4)

Negative Gearing and Lending Standards for Housing & Financial Stability (Submitted to FSI with changes).

- Targeted Lending Standards rather than or in combination with tax changes are an alternative and possibly more effective and politically acceptable way to improve outcomes for housing.
- Two ideas that use targeted lending are offered for consideration that may improve the following outcomes
    - Affordability for first home buyers
    - Drives a better wedge between new and existing housing for investors than tax changes
    - Financial Stability
    - Existing investors not affected.
    - Negative gearing and 50% capital gains tax stays

Question 22 (page 17)

Superannuation

- Access to Superannuation should not be allowed
- Super and Pensions funds combined and earnings taxed at 10%.
- A new idea is offered that considers using the contributions from the bottom up tax bands. The outcomes this may achieve are as follows
    - Possibly save $16 Bn in forgone revenue for treasury now,
    - Remove the 15% tax on contributions.
    - Increase retirement balances.
    - Contributions treated as income during drawdown thus reducing pension payments.
    - Considerable upside revenue opportunity

Age Pension

- No change to age pension amount, but
- The principal residence above a certain amount should be included in means testing, with pensioners still paid a pension, but debt repaid on death to government.

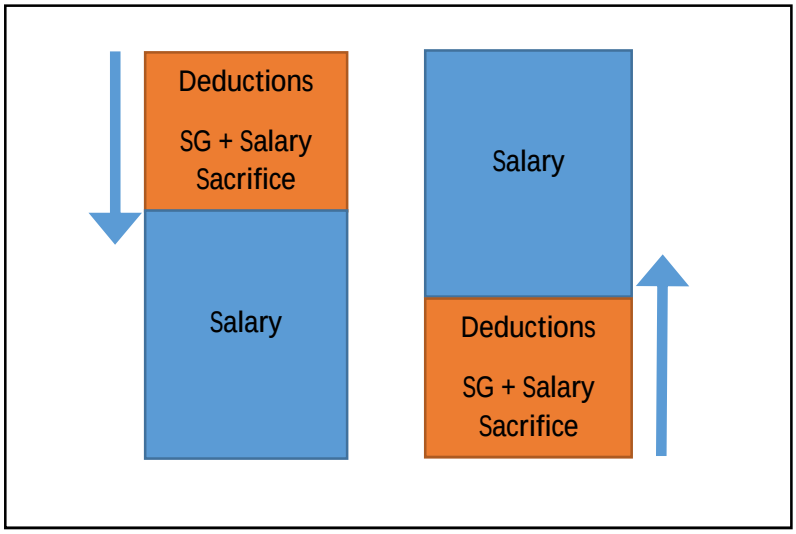
Question 6

What should our individual tax system look like and why?

Tax Scale - Deductions and Contributions

One idea for a simpler and fairer tax scale is to apply deductions and super contributions from the bottom up. See Figure 1.

Figure 1 – Concept of how deductions and contributions are taxed



As a concept, the outcomes would mean the following

- All income levels receive the same deduction rate for losses applied to income.
- All income levels receive the same deduction rate (incentive) for Super Contributions.

The $0 - $18,700 tax band would need to be increased to say 10 % tax to thus provide an incentive for investment deductions, lending and super contributions. It may also mean some form of rebate and offsets for low income earners.

The tax scale should be a little flatter. With a minimum 10% rate with a maximum 40% rate, with 20% and 30% as increments. The maximum rate should not be lower than 40% as a rule.

The current two bottom tax bands should be combined to 10% up to $37,000. This then allows super contributions to receive a tax deduction and thus be treated as income during drawdown. It also means the 15% super contribution tax can be removed. But tax captured from the top marginal tax rate is not lost and thus government revenue is protected.

Having a 10% rate then aligns with combining superannuation and pension fund earnings. This makes super a single solution over the full lifecycle of a person's life.

Deductions for losses is reduced from the bottom up method, but is partially countered with an increase in net income at higher tax rates due to a small reduction from say 45% to 40%. Lower

deductions may lower the incentive to leverage. But this may have the advantage of improving financial stability, and move people to more savings rather than leverage.

Further detail on how this can be applied to superannuation is further in the paper.

Question 21

Do the CGT and negative gearing influence savings and investment decisions, and if so, why?

I would argue that lending standards in fact play the biggest role in the behaviour of investments with negative gearing and capital gains tax a lesser role.

At the moment lending standards are not applied evenly across all investments, but negative gearing and capital gains tax is.

If macro prudential rules had say a 30-40% requirement on all investments, this would impact housing more than shares. And of course where are all the problems at the moment? Housing.

What was the cause of the global financial crisis? there are multiple things, but predominantly a lowering of regulation around lending. Not tax.

Less lending means less investment, but maybe that's what is needed.

In my opinion, lending standards when combined with a shortage of housing e.g. in Sydney are the two biggest factors, but then when combined with the 50% CGT and negative gearing just exacerbate it further.

With housing, the design flaw in this is that there is no differentiation between new and existing housing with both lending and tax rules for investment.

Overall, CGT and negative gearing do influence investment, and do make investments more attractive than bank deposits.

For me, the question is, can tax be used in combination with lending standards to create better outcomes.

In my opinion APRA need to look beyond using macro prudential rules just for capital loss, and start being smart and using them to direct investment in the right direction.

I can see that rules for lending don't differentiate between new and existing housing. But the question is what if they were, what outcomes could be achieved?

The following is an analysis of two ideas of which the second is my idea on how lending standards could influences outcomes, especially around housing, given its causing all the problems.

Negative Gearing (Tax) and Lending (APRA)

(This was submitted to the Financial System Inquiry. It contains some changes)

Executive Summary

- Rather than remove/change one or both negative gearing and the 50% capital gains tax, a different idea is for new Investors who buy existing housing to be regulated to either
    - Neutral gearing/lending
    - A maximum leverage based on a percentage of long term rental yield and interest rates.
- Lending standards need to be preventative and not reactive

Outcomes

- Affordability for first home buyers when interest rates fall
- Drives a better wedge between new and existing housing for investors than tax changes when interest rates fall and yields are low leading to better productive use of tax concessions, and thus increasing supply of housing.
- Financial stability
- Existing investors are not affected

Housing Issues

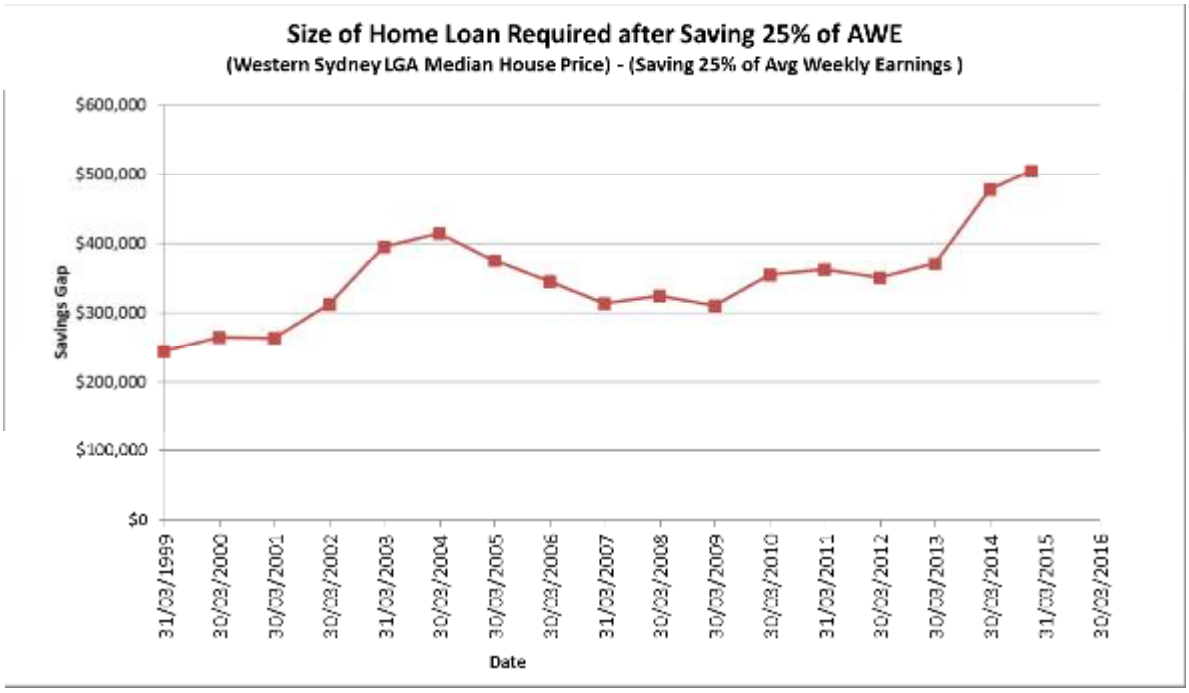
Home ownership has declined for the younger cohort in the past two decades due to a combination of poor design of tax and regulation lending standards. It's obvious from the Global Financial Crisis that reduction of regulated lending was a main cause.

The Grattan Institutes Paper on "The Wealth of Generations" published in December 2014 highlighted the intergenerational wealth for younger Australians has gone backwards when compared to their previous cohorts.

To highlight the difficulty of house prices in Sydney, figure 2 shows a single person who takes a rent and save strategy. Using average weekly earnings and saving 25% of their income, and earning 3% interest. It shows that in 1999 a $245,000 loan is required. After 16 years of saving, the loan required now is about $500,000. Single people on average weekly earnings have gone backwards by about $250,000. It also implies that buying a house as early as possible is preferred.

Data referenced for this is ABS, NSW Housing Land and Property Information.

Figure 2 – Loan Size required after saving 25% of average weekly earnings



One of the problems with higher house prices, is it forces single people to rent for longer, and not only miss out on capital gains, but may end up renting in retirement. Given the current assets test arrangements to exclude the principal residence, this means people with some form of super will try to increase their pension by buying a property in a country area and move away from their family. Yet if all assets were included in the test, staying where they are in, whether they rent or buy means they are closer to family.

Housing is becoming a divisive issue, with those who invest in property competing with those who are either single or in government housing less likely to reach home ownership, and thus ultimately being affected by the assets test later in life.

Nearly 80-95% of lending to investors over the past two decades has skewed towards existing housing. In recent months lending to investors for housing reached over $11bn per month (ABS 5609) as shown in Figure 3.

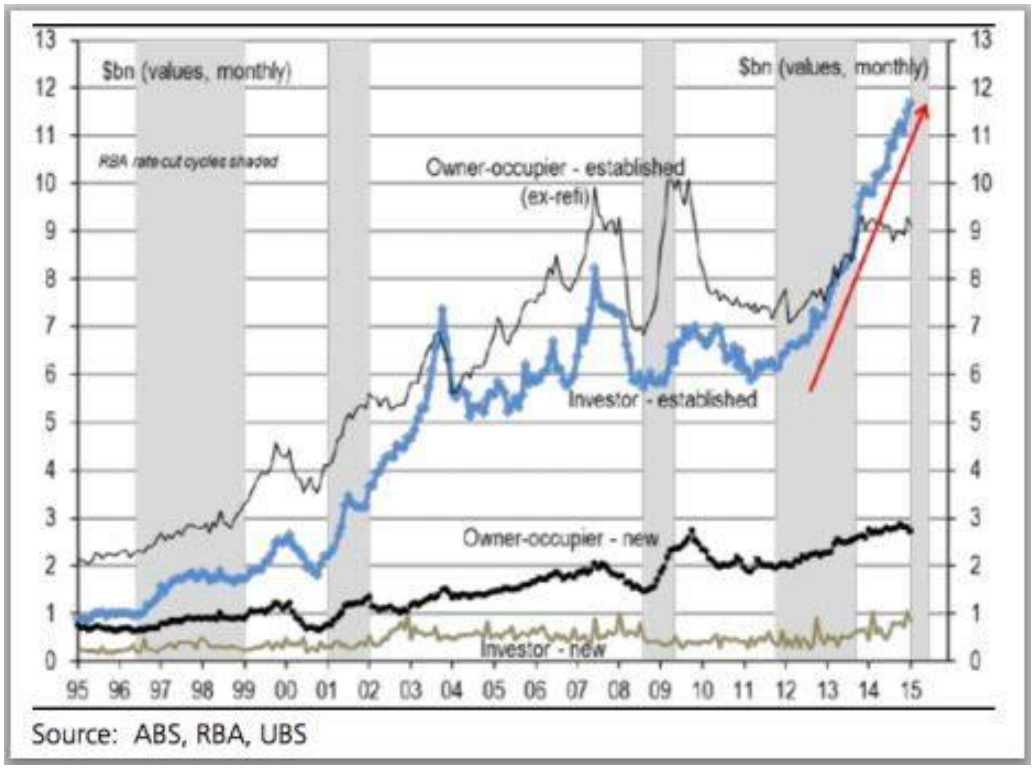
The following graph highlights that investors have doubled the value of loans into existing properties in the past 3 years.

From 1995, investor lending into new housing has increased by about 4 to 5 times. Compared with investment into existing housing which has increased about 12 times.

This high amount of lending has just brought forward prices and essentially transferred opportunities for young first home buyers into the hands of existing home owners and investors. Meaning wealth transfer. Yet the younger generation are left to pay the pensions that rise above inflation even though some have their wages capped at inflation.

And the number of pensioners will double compared to the ratio of the younger generation. It doesn't add up.

Figure 3 – Lending $bn per month to housing types (the eureka report, ABS, RBA and UBS)



Mr David Murray in the Sydney Morning Herald on the 4 March 2015, stated that *the current environment was not only making housing unaffordable, but putting the entire financial system at severe risk*.

Overall, this has pushed out families from buying to establish and create their family and delay their spending on furnishing their home. So social outcomes have been compromised.

The argument that it's only a supply side problem is false. I would argue it's both supply and demand that includes existing lending standards and poorly directed tax arrangements of which when

combined creates aggressive investor activity that is driven by fear of missing out, not fundamentals. Hence this is where affordability and financial stability are compromised.

In existing property, Investors in Sydney have held rents down at the expense of driving prices up on existing properties. This is quite evident by 15-20% rise in prices and 0-3% rise in rent in the last two years. Almost identical to 2002-03. But in addition, the long term trend is that both rents and house values have risen above wages growth, indicating an overall supply problem as well.

Looking at the long term trend, house values have appreciated a lot more than rents. Which is shown in Table 1. In 1999 rent versus house value were probably considered fair value at around 4.9% gross yield. In the following 15 years investors have been piling into the market buying up everything. Housing now has a gross yield of 3.1% or (PE Ratio of 31.9).

Table 1 is from NSW Land and Property Information for a greater Western Sydney LGA and compares house values and rents between 1999 and 2014.

Table 1 – House value and rents for a western Sydney LGA, comparison of 1999 to 2014.

	House Value $	Rent $/ week	Gross Yield	PE Ratio
Mar 1999	245,000	230	4.9%	20.5
Dec 2014	795,000	480	3.1%	31.9
Annual Increase	8.2 % p.a.	5.1% p.a.		Expanding by 3.1% p.a.

In my opinion, the PE ratio should return to about 20 to be considered balanced between house values and rents in existing housing in Sydney. Though I'm sure it will be argued that no number should be given.

But the counter question to this is what the benefits are if we did?

With a current PE ratio near 33 (3% yield) in Sydney compared to the ASX200 of about 17, highlights the over investment in the property market. And this yield doesn't take into account expenses of the property.

Based on the NSW Land and Property data via NSW Housing, currently the average price in a selected Western Sydney LGA is $795,000 with rent at $480 per week. That is a PE of 31.9. To reduce this to a PE of 20, a 26.3% reduction in price, and a 26.3% increase in rents is required. This would be $629,000 and rent of $606.

Lending - Macro Prudential Rules

In recent months both the RBA and APRA have stepped up their verbal warnings, because lending for housing essentially has held the economy to ransom. APRA's 10% growth in lending and 7% floor, is all too late and not effective, because the price gains have been made, and thus investors can just leverage against their collateral again. Given some areas have risen by 30%, having a 10 to 20% deposit requirement won't stop investor lending.

And having a 7% floor, means investment rental income reduces this to about 4%, with the remainder written off on income so the effective floor might be down to 2.2%.

None of this addresses the structural problem of declining home ownership and financial stability.

Table 2 shows the price and percentage increase to buy the next property that can be leveraged based on a minimum deposit. The table shows that if the minimum 5% were required, the next house could be purchased when prices rise by only 5.3%. As more houses are purchased, the increase required for the next house is less.

It highlights how quickly existing home owners can not only double their money on their deposit very quickly, but can leverage into more properties when lending standards are too relaxed and left up to the banks to decide their own capital loss requirements. It also highlights how existing home owners can very quickly drive first home buyers out of the market when interest rates fall.

Table 2 – Comparison of Deposit and Leverage capability (*For conceptual appreciation, paydown of principal, stamp duty and other fees and charges and losses applied to income have been ignored*)

	The increase in price and % required to purchase the next property							
	5% Deposit		10% Deposit		20% Deposit		30% deposit	
	$ Price	% Increase required	$ Price	% Increase required	$ Price	% Increase required	$ Price	% Increase required
Principal Home	$ 500,000		$ 500,000		$ 500,000		$ 500,000	
Investment Property No 1	$ 526,316	5.3%	$ 555,556	11.1%	$ 624,220	24.8%	$ 714,286	42.9%
Investment Property No 2	$ 539,811	2.6%	$ 584,795	5.3%	$ 694,444	11.3%	$ 840,336	17.6%
Investment Property No 3	$ 548,960	1.7%	$ 604,961	3.4%	$ 744,048	7.1%	$ 933,707	11.1%
Investment Property No 4	$ 555,909	1.3%	$ 620,472	2.6%	$ 783,208	5.3%	$ 1,009,413	8.1%
Investment Property No 5	$ 561,525	1.0%	$ 633,135	2.0%	$ 815,842	4.2%	$ 1,073,843	6.4%

The table above in the view of an investor is about making money and financial security, which sounds like a plausible ideal, but it's also 5 houses that don't have home owners.

Given the lack of new supply of housing in Sydney, both lending standards and tax incentives need to be looked at together to create better outcomes.

For the long term, preventative regulation should be put in place.

Suggested Alternatives

Two alternatives are considered.

- Alternative 1 is neutral lending
- Alternative 2 is to regulate maximum % lent based on a ratio of interest rates and gross yield together. (% x Y)

For alternative 2, finding the balance between boosting the economy, home ownership and housing affordability should be designed where a PE ratio of about 20 is chosen as a target. This represents a 5% yield, which was apparent in Sydney in 1999, before the 2002-03 sharp rises. In addition where interest rates are lower than the long term average of about 7%, a ratio is also applied.

The benefit with this approach, is that there is no change to tax incentives such as negative gearing and the 50% capital gains tax.

Regulating lending I would assume is a far more politically easier sell to the public because you are not over-lending in the first place, hence there is no investment losses applied to income.

Mr David Murray mentioned neutral gearing and no one really commented in the media. In the Sydney Morning Herald, neutral gearing was again mentioned on the 17 March 2015, as being a friendlier option than removing negative gearing.

The other apparent problem is that lending into existing property is so much easier than new properties and there is no major difference in capital requirements from my understanding. Hence some form of incentive is required to divert investor lending to new property, when either interest rates are low and/or yields are low.

The design should also consider financial stability at low interest rates. Meaning lending into non-productive activities is reduced, but increased into productive activities.

Alternative 2 in this paper attempts to address these problems.

Alternative 1

Neutral Lending for Investors in Existing Property

Neutral Gearing has recently been mentioned by David Murray in the Sydney Morning Herald on the 4 March 2015.

$$Max\ Lent = Where\ rental\ income\ matches\ Interest\ on\ loan$$

Neutral lending will reduce the amount of money investors can be lent, thus reducing the activity of investors in existing housing. Though its impact on the financial system under falling interest rates is questionable.

The following table shows the maximum % lent based on interest rate and gross yield. It is assumed 90% is the maximum lent. In Sydney the current yield is about 3-3.5% with the RBA Standard interest rate at 5.65% and is shown as brown cells in table 3.

Table 3 – Matrix of Interest Rates and Gross Yield for Neutral Lending

		← Interest Rate										
		4.0%	4.5%	5.0%	5.5%	6.0%	6.5%	7.0%	7.5%	8.0%	8.5%	9.0%
Gross Yield	3.0%	75%	67%	60%	55%	50%	46%	43%	40%	38%	35%	33%
	3.5%	88%	78%	70%	64%	58%	54%	50%	47%	44%	41%	39%
	4.0%	90%	89%	80%	73%	67%	62%	57%	53%	50%	47%	44%
	4.5%	90%	90%	90%	82%	75%	69%	64%	60%	56%	53%	50%
	5.0%	90%	90%	90%	90%	83%	77%	71%	67%	63%	59%	56%
	5.5%	90%	90%	90%	90%	90%	85%	79%	73%	69%	65%	61%
	6.0%	90%	90%	90%	90%	90%	90%	86%	80%	75%	71%	67%
	6.5%	90%	90%	90%	90%	90%	90%	90%	87%	81%	76%	72%
	7.0%	90%	90%	90%	90%	90%	90%	90%	90%	88%	82%	78%
	7.5%	90%	90%	90%	90%	90%	90%	90%	90%	90%	88%	83%

It shows the maximum % lent increases as interest rates fall, and thus it becomes more attractive for investors, still making it difficult for first home owners to compete. At very high interest rates, yields will increase significantly with rents rising rapidly. Hence the need to bring investors back into the market to reduce rents. This is where alternative 2 works better.

Example

The median house value in Greater Sydney is about $720,000 with rent at $450 / week (NSW Land and Property Information). This is a yield of 3.2%.

With loan interest at 5%, this means a maximum of 64% of the house value could be lent. And thus a 36% deposit is required.

If someone has $144,000 collateral in their $720,000 home, and wanted to use ($72,000 or 10%) for collateral to buy another existing property for $720,000, they could only borrow 64%. They would need a $259,200 deposit. They are $187,200 short.

But they could borrow the full amount of $720,000 and use negative gearing if they bought a new property.

Table 4 shows 15 years of data, and the application of neutral gearing. The average lent would be 56% of the value of the house.

Table 4 – A western Sydney LGA, historical data and analysis, Data from: NSW Land and Property Information, NSW Housing, and RBA.

Neutral Gearing - Western Sydney Suburb LGA					
	RBA Std Var	Median House Value	Rent $/week	Gross Yield	Max % Lent
31/03/1999	6.50%	$ 245,000	230	4.9%	75%
31/03/2000	7.30%	$ 275,000	250	4.7%	65%
31/03/2001	7.30%	$ 285,000	270	4.9%	67%
31/03/2002	6.05%	$ 346,000	260	3.9%	65%
31/03/2003	6.55%	$ 441,000	260	3.1%	47%
31/03/2004	7.05%	$ 475,000	260	2.8%	40%
31/03/2005	7.30%	$ 450,000	270	3.1%	43%
31/03/2006	7.30%	$ 435,000	280	3.3%	46%
31/03/2007	8.05%	$ 421,000	300	3.7%	46%
31/03/2008	9.35%	$ 450,000	340	3.9%	42%
31/03/2009	5.85%	$ 455,000	375	4.3%	73%
31/03/2010	6.90%	$ 520,000	400	4.0%	58%
31/03/2011	7.80%	$ 550,000	420	4.0%	51%
31/03/2012	7.40%	$ 561,000	450	4.2%	56%
31/03/2013	6.45%	$ 606,000	450	3.9%	60%
31/03/2014	5.95%	$ 740,000	465	3.3%	55%
Average	7.1%			3.9%	56%

Alternative 2

Using interest rates and rental yield to regulate lending to Investors in Existing Property (% and Y)

The concept is that beyond the long term average of interest rates and gross yield, investor leveraging into existing property is considered speculative and thus should require a higher deposit as a proportional percentage of the average rates. This would not apply to new property.

For example, if the long term average for gross yield is say 5% (PE ratio = 20) and the interest rate is 7%, from this a maximum % lent is calculated as follows. For the purpose of this paper, a maximum of 90% has been assumed.

$$Max\ \%\ Lent\ =\ Lesser\ of\ 90\%$$

$$or$$

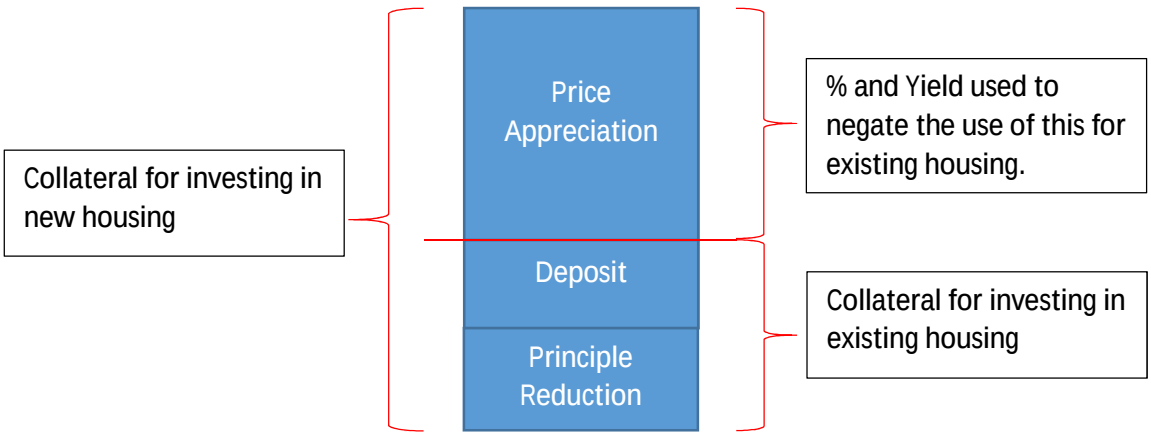
$$(90\%)\ x\ \frac{Current\ Interest\ Rate\ \% \leq 7\%}{7\%}\ x\ \frac{Current\ Gross\ Yield\ \%}{5\%}$$

APRA's Capital Requirements (Protects Banks)	Counters any price increase from falling interest rates below 7%. (National)	Counters any price increase when yield is less than 5%. Or where the PE ratio exceeds 20. (Local LGA)

By having three separate numbers, these are adjusted based on APRA's requirements for capital, the RBA's rate changes, and local government area yields.

When interest rates and or gross yields fall, it is assumed there is an inverse price rise. Hence the equation tries to neutralise the collateral made from price rises with a matching reduction in money lent. This stops investors leveraging off collateral made from price rises. Figure 4 shows an existing home owner's collateral and the components targeted when yield and interest rates are below their target.

Figure 4 – Components used for collateral for investors in new and existing housing



To buy a second existing property, the investor is forced to build collateral (Say 10%) from savings or by paying down their principle loan. This could be increased to 20% or 30% if required by APRA. Additionally as rents rise, the maximum % lent would increase.

When interest rates or yields are lower than the target, first home buyers and home purchases can drive market prices, and increase home ownership. If rents start to rise, the max % lent is increased and investors are incentivised to return until reaching the 5% yield.

Table 5 provides an example of what the maximum % lent would be for a matrix of numbers. Currently in Sydney, the gross yield is near 3-3.5% and the RBA Standard interest rate at 5.65%. Hence the maximum lent is about 45%. Or a 55% deposit.

Table 5 - Matrix of Interest Rates and Gross Yield for Alternative 2 (% and Y)

		← Interest Rate										
		4.0%	4.5%	5.0%	5.5%	6.0%	6.5%	7.0%	7.5%	8.0%	8.5%	9.0%
Gross Yield	3.0%	31%	35%	39%	42%	46%	50%	54%	54%	54%	54%	54%
	3.5%	36%	41%	45%	50%	54%	59%	63%	63%	63%	63%	63%
	4.0%	41%	46%	51%	57%	62%	67%	72%	72%	72%	72%	72%
	4.5%	46%	52%	58%	64%	69%	75%	81%	81%	81%	81%	81%
	5.0%	51%	58%	64%	71%	77%	84%	90%	90%	90%	90%	90%
	5.5%	57%	64%	71%	78%	85%	90%	90%	90%	90%	90%	90%
	6.0%	62%	69%	77%	85%	90%	90%	90%	90%	90%	90%	90%
	6.5%	67%	75%	84%	90%	90%	90%	90%	90%	90%	90%	90%
	7.0%	72%	81%	90%	90%	90%	90%	90%	90%	90%	90%	90%
	7.5%	77%	87%	90%	90%	90%	90%	90%	90%	90%	90%	90%

For 90%, no change to current arrangements.

Note that when interest rates fall, the maximum amount lent reduces not increases as it does with neutral gearing. (i.e. possibly good for Financial Stability)

The area where the 90% maximum lent occurs, this is the current arrangements. Negative gearing and the 50% capital gains tax is still applicable.

Example

An owner occupier bought their $500,000 home with a 10% deposit of $50,000. The rental yield in the area is assumed to be 5% and interest rates at 7%. After a year, a price increase of 20% occurs due to investors flooding the market with no increase in rents, pushing the rental yield down to 4.17%. They now have $150,000 as collateral. They wish to buy an investment property identical to their home for $600,000. The $100,000 (150-50) collateral for the investment property is 16.7% of the value of the new investment.

Under Alternative 2, they require collateral of $600,000 x (1-(0.9 x (7/7) x (4.17/5))) = $150,000 or 25%. They are $50,000 short.

Then the RBA announces a shock to the financial system and interest rates are to be reduced from 7% to 5% immediately. Sellers push up their asking price in anticipation by a further 40% or (7/5) to $840,000. If this was the valuation, the collateral in their own home would be $390,000 (840-450).

The maximum lent then becomes (1 - (0.9 x (5/7) x (4.17/5))) = 46.4%. Hence the deposit required increases to (1-0.464) x $840,000 = $450,000. Again the remaining collateral of $340,000 (390-50) for the investment property is still not enough. Using collateral from price escalation has been designed out.

But they would have the minimum (say 10%) ($84,000) to buy a newly created house or unit from a developer.

Note: if 0.9 is removed from the equation, the maximum lent aligns with the collateral built up. It implies the investor has to build collateral by paying down their principle, to be able to buy an existing investment property.

In the example, the rents did not rise. If they did, this would increase yield, and thus increase the max % lent.

Table 6 shows the maximum percentage lent using alternative 2 to a set of real data from a Western Sydney LGA.

Table 6 – A western Sydney LGA, historical data and analysis, Data from: NSW Land and Property Information, NSW Housing, and RBA.

Maximum % Lent - Western Sydney LGA Housing Data					
	Median House Value	Rent $/week	RBA Std Var	Gross Yield	Max % Lent
31/03/1999	$ 245,000	230	6.50%	4.9%	82%
31/03/2000	$ 275,000	250	7.30%	4.7%	85%
31/03/2001	$ 285,000	270	7.30%	4.9%	89%
31/03/2002	$ 346,000	260	6.05%	3.9%	61%
31/03/2003	$ 441,000	260	6.55%	3.1%	52%
31/03/2004	$ 475,000	260	7.05%	2.8%	51%
31/03/2005	$ 450,000	270	7.30%	3.1%	56%
31/03/2006	$ 435,000	280	7.30%	3.3%	60%
31/03/2007	$ 421,000	300	8.05%	3.7%	67%
31/03/2008	$ 450,000	340	9.35%	3.9%	71%
31/03/2009	$ 455,000	375	5.85%	4.3%	64%
31/03/2010	$ 520,000	400	6.90%	4.0%	71%
31/03/2011	$ 550,000	420	7.80%	4.0%	71%
31/03/2012	$ 561,000	450	7.40%	4.2%	75%
31/03/2013	$ 606,000	450	6.45%	3.9%	64%
31/03/2014	$ 740,000	465	5.95%	3.3%	50%
31/12/2014	$ 795,000	480	5.95%	3.1%	48%
3/02/2015	$ 795,000	480	5.65%	3.1%	46%
Average			7.1%	3.9%	67%

The table above highlights that in 2002-03 and 2012-15, the maximum lent reduces significantly and rapidly. For February 2015 a deposit of $429,300 is required for a $795,000 home.

Discussion

Changing lending standards, possibly gives a greater leverage at achieving better outcomes than removing or adjusting negative gearing and/or capital gains taxes.

In both alternatives, negative gearing and the 50% tax deduction can stay.

Existing investors are unaffected. As are investors into new property.

Alternative 2 is designed to cope with a dynamic system of changing interest rates and yields to balance the system to a set of target rates determined to be a balance point that blunt and incentivise lending into existing housing.

The hurdle with alternative 2, is the "assumption" that existing house prices are a proxy for creating new housing. If first home buyers and existing upgrading home owners are buying above the PE ratio of 20, supported by low interest rates, then this should help prices move up, albeit not as fast as investors create. And this may be an advantage for financial stability as you are removing some investors who are using collateral from previous price rises to buy.

Using lending standards to achieve a wedge between new and existing property is highlighted by alternative 2 where low interest rates and yield create a deposit required for new property at $84,000 versus a $450,000 for an existing property. This is something that tax rules for example applying negative gearing only to new property cannot achieve.

Alternative 2 appears to provide affordability opportunities for first home buyers, balances prices and rents, and incentivises investor lending into new property as interest rates fall, but back into existing property when rents become too high.

Conclusion

The council of financial regulators should reconsider APRA's purpose, measures and standards and include home ownership and affordability. The approach should be preventative rather than reactive.

Question 22

How appropriate are the tax arrangements for superannuation in terms of their fairness and complexity? How could they be improved?

Tax concessions if any on contributions should be equal for all income levels. Hence a bottom up approach could be considered. An analysis of this is on the following page.

The pension phase should be taxed at 10%, meaning superannuation just becomes a single whole of life cycle account.

Taxing the drawdown phase should be considered as it creates a wedge to incentivise retirees into annuities thus reducing longevity risks.

Superannuation should be designed only for retirement income, not wealth accumulation and debt reduction.

Generation X and Y will probably carry a lot of debt into retirement, and will be looking to access their super to pay down debt. This is a problem if housing is not included in the assets test. Hence lump sum withdrawals should either be lowered or removed. For example a maximum 15% can be withdrawn in any one year.

Superannuation

Access to Superannuation for home purchase

There should be no access to superannuation. From an individual's point of view, it seems obvious that the extra money makes a bigger deposit. But from a systems perspective, unleashing a population of people with extra money is equivalent to multiple interest rate reductions all at once. This may create financial stability and drive up housing prices.

Other risks include the lack of diversification, resulting in a poor retirement balance and further reliance on other tax payers.

In the near future baby boomers will start to drawdown, and as such in combination will reduce the pool of savings. Thus eroding the buffer against financial shocks.

The productivity commission in its 2014 National Commission of Audit repot identified that:

> *Exempting the principal residence from the means test is inequitable as it allows for high levels of wealth to be sheltered from means testing. For example, under the current rules a single person who owns a $400,000 house and has $750,000 in shares ($1.15 million in total assets) would not be eligible for the pension, while a similar person with a principal residence worth $2 million and $100,000 in shares ($2.1 million in total assets) would be able to claim a pension at the full rate.*

Having superannuation placed into the principal residence will leave tax payers the bill of supporting pensioners who hide excessive assets within the family home. This create a significantly unbalanced and poorly diversified financial system vulnerable to shocks.

In May 2006 the House of Representatives Standing Committee on Economics, Finance and Public Administration finalised the inquiry into "Improving the superannuation savings of people under 40".

Here are a few conclusions:

> 3.93 - the overriding drawback was that the purpose for which the contributions were being made were being undermined.
>
> 3.99 – Muddying superannuation's purpose with early access schemes will not only increase complexity but will introduce inequities in the system. Where an access scheme specifically incorporates a sector of the economy, for example housing, it may also cause unintended and adverse consequences, like price inflation.
>
> 3.100 – The concessional tax treatment is given on the basis that when a person draws down on their superannuation balance in retirement that it is utilised to improve the retiree's living standard.
>
> 3.101- In a global environment of structural ageing, reducing the fiscal cost of a growing quantum of age pensions is vital. Thus taxation incentives are given to encourage voluntary superannuation contributions. The monies are therefore not intended to be used for non-retirement purposes.

Superannuation Design – Taxing of Contributions

Five designs, four of which are well known for the design of superannuation are analysed. A summary of these are in Table 7. The analysis focuses on the contribution component only. Interest on contributions and undeducted contributions is excluded.

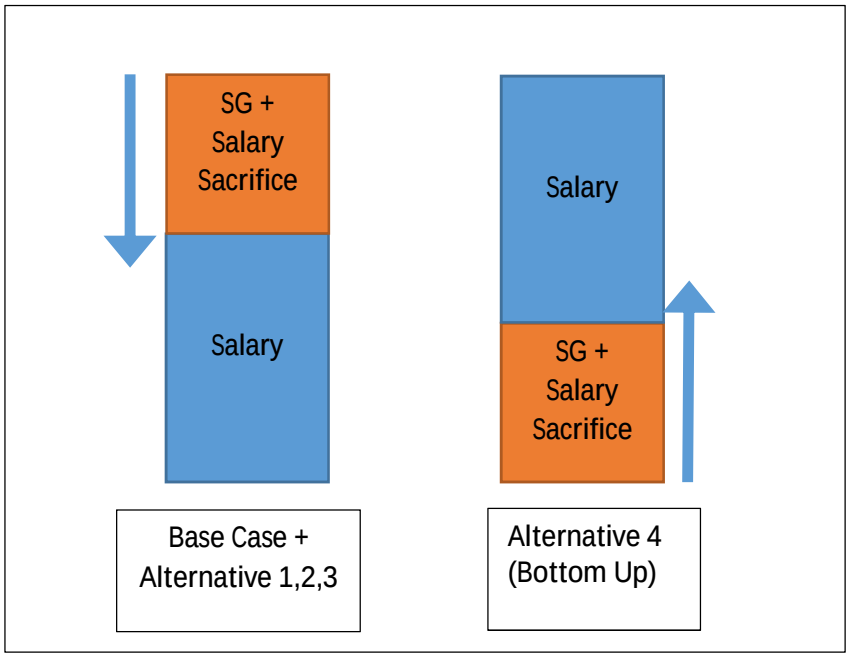
Table 7 – Alternatives for contributions

Alternatives	Design Summary
Base Case	Contributions are from the top down, or last dollars earned of income Contributions are taxed at 15% Contributions are treated as income in the drawdown phase.
Alt 1	Contributions are from the top down, or last dollars earned of income Contributions are taxed at the marginal rate Contributions are treated as capital (undeducted) in the drawdown phase
Alt 2	Alt 1 but 15% rebate on contribution
Alt 3 – Suspected to be preferred option)	Alt 1 but 15% rebate on contribution Contributions are treated as income in the drawdown phase
Alt 4	Contributions are from the bottom up, or first dollars earned of income Contributions tax of 15% is removed. (Contributions above 19% are rebated back into contribution) Contributions are treated as income in the drawdown phase. Gross Salary and Tax Scale are collapsed by the contribution amount

For the base case and alternatives 1, 2 and 3, the design and analysis take the contribution from the top down, or the last few dollars earned of income.

Figure 5 shows the concept of Alternative 4 that considers contributions from the bottom up of income.

Figure 5 – Concepts for Contribution Design



The idea is that the first $18,700 of the tax free threshold, plus the additional 19% tax rate up to the $30,000 is deferred as income until drawdown into the future and then assessed as income and not capital for tax and pension assessment then.

Though the tax scales could be changed so that the $0 to $18,700 tax band is say 10% or 15%, thus the contributions receive a concession, meaning they are treated as income during drawdown.

But if this was not the case, it would mean rebating the tax paid within the 19% tax band for those who exceed $18,700 up to $30,000. This would be in the order of ($2147 = 0.19 x 11,300). But the tax rate and threshold could be adjusted to adjust the rebate.

Super contributions are neither subject to the marginal tax rate or the contribution tax of 15%. Meaning the highest possible contribution is made across all income levels.

It also means those on the lowest tax band that are penalised with a 15% contributions tax, now can have their full amount invested.

The design will need to collapse the person's gross salary and tax scale by the amount of the contribution. So I don't know exactly what that will mean for complexity, but it's worth investigating

For example if a person on a gross salary of $280,000 contributes $30,000 to super, their salary is $250,000. Because the contribution is taken from the bottom up, the tax scales are then reduced by the same amount.

Table 8 shows that after a $30,000 super contribution, the first tax scale from the bottom will be 19% up to $7000. Then 32.5% tax from $7,001 to $50,000.

Table 8 – Tax Scales before and after contribution

Tax Scale Before	Tax Rate	Tax Scale After $30k Super Contribution	Tax Rate
$ -	0.000	$ -	0.190
$ 18,200	0.190	$ 7,000	0.325
$ 37,000	0.325	$ 50,000	0.370
$ 80,000	0.370	$ 150,000	0.450
$ 180,000	0.450		

Effectively the person is not being taxed for the contribution in the year the salary is earned, and is moved to the future into the drawdown phase.

Analysis

The analysis is only basic and intended for appreciation of the concept. The analysis focuses on the contribution component. The analysis assumes a 12% Super Guarantee rate (Currently 9.25%) and up to $30,000 contributions (< age 50).

Table 9 shows the net income received in the hand, and taxes paid. Taxes paid exclude the 15% contribution tax. That is shown in the following tables.

Table 9 – Net Income for each alternative

Net Income

		Base Case	Alternative 1	Alternative 2	Alternative 3	Alternative 4
Salary Package (Includes 12% SG)	Gross Income	SG Cont before Gross Income	Full Marginal Tax - SG after tax	Full Marginal Tax - SG after tax - (15% rebate on Cont)	Full Marginal Tax - SG after tax - (15% rebate on Cont)	Bottom Up - SG Before Gross Income
$ 18,200	$ 16,250	$ 16,250	$ 16,250	$ 16,250	$ 16,250	$ 16,250
$ 37,000	$ 33,036	$ 30,217	$ 30,217	$ 30,217	$ 30,217	$ 29,464
$ 80,000	$ 71,429	$ 56,667	$ 56,667	$ 56,667	$ 56,667	$ 53,882
$ 180,000	$ 160,714	$ 113,303	$ 113,303	$ 113,303	$ 113,303	$ 109,553
$ 280,000	$ 250,000	$ 163,953	$ 163,953	$ 163,953	$ 163,953	$ 152,695

Table 10 – Tax paid for each alternative

Tax Paid

		Base Case	Alternative 1	Alternative 2	Alternative 3	Alternative 4
Salary Package (Includes 12% SG)	Gross Income	SG Cont before Gross Income	Full Marginal Tax - SG after tax	Full Marginal Tax - SG after tax - (15% rebate on Cont)	Full Marginal Tax - SG after tax - (15% rebate on Cont)	Bottom Up - SG Before Gross Income
$ 18,200	$ 16,250	$ -	$ -	$ -	$ -	
$ 37,000	$ 33,036	$ 2,819	$ 2,819	$ 2,819	$ 2,819	$ 3,470
$ 80,000	$ 71,429	$ 14,761	$ 14,761	$ 14,761	$ 14,761	$ 17,452
$ 180,000	$ 160,714	$ 47,411	$ 47,411	$ 47,411	$ 47,411	$ 54,341
$ 280,000	$ 250,000	$ 86,047	$ 86,047	$ 86,047	$ 86,047	$ 97,305

The analysis shows that as salary increases, the bottom up approach provides less income. This is because income from the 0% tax rate portion ($1000 x (100%-0%)) is replaced by income from the individual's highest marginal tax rate e.g. 45%, ($1000 x (100%- 45%)). Hence a higher salary package means less pay.

The following table 11, provides a breakdown in net income reduction for alternative 4

Table 11 – Alternative 4 net income reduction compared with base case

Gross Salary Package	Alternative 4 Net Reduction in Income	
	$ Year	$ per week
$18,200	$0	0
$37,000	$553	$10.53
$80,000	$2,785	$53.56
$180,000	$3,750	$72.11
$280,000	$11,258	$216.50

The following tables 12 to 16 are an analysis of the five alternatives.

The assumption made in the drawdown phase is that the yearly contribution is then drawdown (same amount) plus a taper rate is applied and then added to the pension to arrive at an income.

It's not totally correct to assume there will be a taper for high income earners as their balance is too high for the pension. But it does highlight if it did.

For alternatives 1 and 2, where their contributions are treated as undeducted contributions in the drawdown (I call this capital), I have assumed only one year of undeducted contributions are contributed and then withdrawn later. When in reality, the total balance of say 30-40 years of contribution would be assessed for the assets and income test, and a higher reduction in pension would occur.

The government revenue columns compare tax revenue during the accumulation phase and extra expense in the drawdown phase if the income is not assessed for the pension (i.e. spent and then received full pension). Red is a deficit (i.e. not good).

Tables 12 to 16 – Comparison of contributions and their outcomes for retirement income and government revenues.

Alternatives for Super Contributions

Superannuation Guarantee Rate 12%

Baseline - Contributions Taxed of 15%, Contributions from the Top Down

								Drawdown Phase			Government	
Example Salary Package	SG	Marginal Rate	Contributions Tax 15%	Difference (C-D)	Tax Revenue loss to Govt (B x E)	Tax Paid to Govt	Yearly Amount into Super after 15% Cont Tax (B x D)		Pension Reduction Taper Rate 50 cents / $1 (G x 0.5)	Retiree Income (Year) Yearly Contribution withdrawn + full pension - pension taper reduction (G + 22000 - I)	Govt Revenue Position (-22000 - F + I)	Govt Revenue Position (Risk if lump sum withdrawal in Drawdown Phase) (K - I)
A	B	C	D	E	F		G	H	I	J	K	L
$ -					$ -	$ -						
$ 18,200	$ 1,950	0.000	0.15	-0.150	-$ 293	$ 293	$ 1,658		$ 829	$ 22,829	-$ 20,586	-$ 21,415
$ 37,000	$ 3,964	0.190	0.15	0.040	$ 159	$ 595	$ 3,370		$ 1,685	$ 23,685	-$ 19,879	-$ 21,564
$ 80,000	$ 8,571	0.325	0.15	0.175	$ 1,500	$ 1,286	$ 7,286		$ 3,643	$ 25,643	-$ 18,571	-$ 22,214
$ 180,000	$ 19,286	0.370	0.15	0.220	$ 4,243	$ 2,893	$ 16,393		$ 8,196	$ 30,196	-$ 15,154	-$ 23,350
$ 280,000	$ 30,000	0.450	0.15	0.300	$ 9,000	$ 4,500	$ 25,500		$ 12,750	$ 34,750	-$ 13,750	-$ 26,500

Alternative 1 - Contribtions are taxed at Marginal Tax Rate (Undeducted Contribution)

								Drawdown Phase			Government	
Example Salary Package	SG	Marginal Rate	Contributions Tax	Difference (C-D)	Tax Revenue loss to Govt (B x E)	Tax Paid to Govt	Yearly Amount into Super after 15% Cont Tax (B x D)	Deeming Rate 3.25%	Pension Reduction Taper Rate 50 cents / $1 (G x 0.5)	Retiree Income (Year) Yearly Contribution withdrawn + full pension - pension taper reduction (G + 22000 - I)	Govt Revenue Position (-22000 - F + I)	Govt Revenue Position (Risk if lump sum withdrawal in Drawdown Phase) (K - I)
A	B	C	D	E	F		G	H	I	J	K	L
$ -					$ -	$ -					$ -	$ -
$ 18,200	$ 1,950	0.000	0.000	0.000	$ -	$ -	$ 1,950	$ 63	$ 32	$ 23,918	-$ 21,968	-$ 22,000
$ 37,000	$ 3,964	0.190	0.190	0.000	$ -	$ 753	$ 3,211	$ 104	$ 52	$ 25,159	-$ 21,195	-$ 21,247
$ 80,000	$ 8,571	0.325	0.325	0.000	$ -	$ 2,786	$ 5,786	$ 188	$ 94	$ 27,692	-$ 19,120	-$ 19,214
$ 180,000	$ 19,286	0.370	0.370	0.000	$ -	$ 7,136	$ 12,150	$ 395	$ 197	$ 33,953	-$ 14,667	-$ 14,864
$ 280,000	$ 30,000	0.450	0.450	0.000	$ -	$ 13,500	$ 16,500	$ 536	$ 268	$ 38,232	-$ 8,232	-$ 8,500

Alternative 2 - Contribtions are taxed at Marginal Tax Rate then 15% rebate on Super Contribution (Treated as Undeducted Contribution)

								Drawdown Phase			Government	
Example Salary Package	SG	Marginal Rate	Contributions Tax (After Rebate)	Difference (C-D)	Tax Revenue loss to Govt (B x E)	Tax Paid to Govt	Yearly Amount into Super after 15% Cont Tax (B x D)	Deeming Rate 3.25%	Pension Reduction Taper Rate 50 cents / $1 (G x 0.5)	Retiree Income (Year) Yearly Contribution withdrawn + full pension - pension taper reduction (G + 22000 - I)	Govt Revenue Position (-22000 - F + I)	Govt Revenue Position (Risk if lump sum withdrawal in Drawdown Phase) (K - I)
A	B	C	D	E	F		G	H	I	J	K	L
$ -					$ -	$ -					$ -	$ -
$ 18,200	$ 1,950	0.000	0.000	0.000	$ -	$ -	$ 1,950	$ 63	$ 32	$ 23,918	-$ 21,968	-$ 22,000
$ 37,000	$ 3,964	0.190	0.040	0.150	$ 595	$ 159	$ 3,806	$ 124	$ 62	$ 25,744	-$ 22,374	-$ 22,436
$ 80,000	$ 8,571	0.325	0.175	0.150	$ 1,286	$ 1,500	$ 7,071	$ 230	$ 115	$ 28,957	-$ 21,671	-$ 21,786
$ 180,000	$ 19,286	0.370	0.220	0.150	$ 2,893	$ 4,243	$ 15,043	$ 489	$ 244	$ 36,798	-$ 20,406	-$ 20,650
$ 280,000	$ 30,000	0.450	0.300	0.150	$ 4,500	$ 9,000	$ 21,000	$ 683	$ 341	$ 42,659	-$ 17,159	-$ 17,500

Alternative 3 - Contribtions are taxed at Marginal Tax Rate then 15% rebate on Super Contribution (Treated As income in drawdown)

								Drawdown Phase			Government	
Example Salary Package	SG	Marginal Rate	Contributions Tax (After Rebate)	Difference (C-D)	Tax Revenue loss to Govt (B x E)	Tax Paid to Govt	Yearly Amount into Super after 15% Cont Tax (B x D)		Pension Reduction Taper Rate 50 cents / $1 (G x 0.5)	Retiree Income (Year) Yearly Contribution withdrawn + full pension - pension taper reduction (G + 22000 - I)	Govt Revenue Position (-22000 - F + I)	Govt Revenue Position (Risk if lump sum withdrawal in Drawdown Phase) (K - I)
A	B	C	D	E	F		G	H	I	J	K	L
$ -					$ -	$ -					$ -	$ -
$ 18,200	$ 1,950	0.000	0.000	0.000	$ -	$ -	$ 1,950		$ 975	$ 22,975	-$ 21,025	-$ 22,000
$ 37,000	$ 3,964	0.190	0.040	0.150	$ 595	$ 159	$ 3,806		$ 1,903	$ 23,903	-$ 20,533	-$ 22,436
$ 80,000	$ 8,571	0.325	0.175	0.150	$ 1,286	$ 1,500	$ 7,071		$ 3,536	$ 25,536	-$ 18,250	-$ 21,786
$ 180,000	$ 19,286	0.370	0.220	0.150	$ 2,893	$ 4,243	$ 15,043		$ 7,521	$ 29,521	-$ 13,129	-$ 20,650
$ 280,000	$ 30,000	0.450	0.300	0.150	$ 4,500	$ 9,000	$ 21,000		$ 10,500	$ 32,500	-$ 7,000	-$ 17,500

Alternative 4 - No Contributions Tax, Contribution from the Bottom Up

								Drawdown Phase			Government	
Example Salary Package	SG	Marginal Rate	SG 0% (0-18700) Tax Rate	SG 19% (18700 - 30000) Tax Rate	Tax Revenue loss to Govt (B x E)	Tax Paid to Govt	Yearly Amount into Super (B)		Pension Reduction Taper Rate 50 cents / $1 (G x 0.5)	Retiree Income (Year) Yearly Contribution withdrawn + full pension - pension taper reduction (G + 22000 - I)	Govt Revenue Position (-22000 - F + I)	Govt Revenue Position (Risk if lump sum withdrawal in Drawdown Phase) (K - I)
A	B	C	D	E	F		G	H	I	J	K	L
$ -											$ -	$ -
$ 18,200	$ 1,950		0.000	0.19	$ -		$ 1,950		$ 975	$ 22,975	-$ 21,025	-$ 22,000
$ 37,000	$ 3,964		0.000	0.19	$ -		$ 3,964		$ 1,982	$ 23,982	-$ 20,018	-$ 22,000
$ 80,000	$ 8,571		0.000	0.19	$ -		$ 8,571		$ 4,286	$ 26,286	-$ 17,714	-$ 22,000
$ 180,000	$ 19,286		0.000	0.19	$ 206		$ 19,286		$ 9,643	$ 31,643	-$ 12,563	-$ 22,206
$ 280,000	$ 30,000		0.000	0.19	$ 2,242		$ 30,000		$ 15,000	$ 37,000	-$ 9,242	-$ 24,242

The following three tables 17 to 19 summarise the alternatives and their government revenue. In each of the table's, the contributions tax is included in the drawdown phase column.

Upside potential assumes all drawdowns are assessed for against the 50% pension taper rate, whereas downside risk is if the contribution is spent, and the retiree is totally reliant upon the age pension.

Table 17 – Government Revenue Ranges for $80,000 Salary Package

	Government Revenue Accumulation Phase	Government Revenue Drawdown Phase		Total Government Revenue	
Design Case	Tax Paid (Table 10)	Upside Potential	Downside Risk	Total Upside	Total Downside
Base Case	$14,761	-$18,571	-$22,214	-$3,990	-$7,453
1	$14,761	-$19,120	-$19,214	-$4,453	-$4,453
2	$14,761	-$21,671	-$21,786	-$6,910	-$7,025
3	$14,761	-$18,250	-$21,786	-$3,489	-$7,025
4	$17,452	-$17,714	-$22,000	-$262	-$7,239

Table 18 – Government Revenue Ranges for $180,000 Salary Package

	Government Revenue Accumulation Phase	Government Revenue Drawdown Phase		Total Government Revenue	
Design Case	Tax Paid (Table 10)	Upside Potential	Downside Risk	Total Upside	Total Downside
Base Case	$47,411	-$15,154	-$23,350	$32,257	$24,061
1	$47,411	-$14,667	-$14,864	$32,744	$32,547
2	$47,411	-$20,406	-$20,650	$27,005	$26,761
3	$47,411	-$13,129	-$20,650	$34,282	$26,761
4	$54,341	-$12,563	-$22,206	$41,778	$32,135

Table 19 – Government Revenue Ranges for $280,000 Salary Packages

	Government Revenue Accumulation Phase	Government Revenue Drawdown Phase		Total Government Revenue	
Design Case	Tax Paid (Table 10)	Upside Potential	Downside Risk	Total Upside	Total Downside
Base Case	$86,047	-$13,750	-$26,500	$72,297	$59,547
1	$86,047	-$8,232	-$8,500	$77,815	$77,547
2	$86,047	-$17,159	-$17,500	$68,888	$68,547
3	$86,047	-$7,000	-$17,500	$79,047	$68,547
4	$97,305	-$9,242	-$24,242	$88,063	$73,063

To look at a comparison of the Base case and alternative 4, table 20 shows the difference through each to further clarify the difference.

Table 20 – How it works comparison

	Comments for Base Case	Base Case	Alternative 4	Comments for Alternative 4
Gross Salary		$280,000	$280,000	
Taxable Income		$0,000 to $250,000	$30,000 to $280,000	
Tax Paid	Starts from $0 upwards	$86,047	$97,305	Starts from $280k downwards
Net Income		$163,953	$152,695	$11,258 or $216/week reduction
Super Contribution		$30,000	$30,000	
Contributions Tax		15%	0%	
Net Contribution		$25,500	$30,000	+17.65% increase over base case
Pension Reduction 50% Taper Rate		$12,750	$15,000	

Discussion

Alternative 4 when compared to the Base Case shows significant upside potential in terms of tax revenue and retirement savings, but it comes at a cost to net income.

So for the same % contribution, revenue and contribution are increased at the expense of take home net income. But the reduction in income is proportionally reduced at lower salaries.

Government revenues forgone could be potentially reduced by about $16 Bn per year (Table 21).

Table 21 – Concessional employer contributions tax, treasury website

Concessional taxation of employer contributions							
Revenue forgone estimates ($b)				Revenue gain estimates ($b)			
2012-13	2013-14	2014-15	2015-16	2012-13	2013-14	2014-15	2015-16
13.2	14.1	16.2	17.3	10.2	10.8	12.3	13.2

The 15% contributions tax can be removed for all income levels.

Alternative 4 provides a higher contribution for all tax payers by 17%. But net income is reduced. For example a gross salary of $37,000 has a reduced income of $10.53 per week. A gross salary of $80,000 has a reduced income of $53.56 per week.

During the drawdown phase, the down side risk of higher pension costs because of lump sum withdrawals is still a risk, but Alternative 4 provides a similar or better outcome than the current base case, but the best solution for downside risk is alternative 1 where all contributions are taxed at the marginal rate.

With alternative 4, access to emergency funds due to special circumstances through the accumulation phase is simpler as contributions are from the 0% tax bracket, and thus do not need to be taxed. Unless the first tax band is increased to 15%.

Conclusion

The assumption that gross salary and the tax scale are collapsed and assessed into the future, and that contributions are treated as income in the drawdown phase is the basis of this analysis for alternative 4. Though changing tax scales so that $0-$37000 becomes a 10 to 15% tax rate would overcome this problem.

The financial system inquiry has suggested that superannuation is being used as a wealth creation vehicle, rather than retirement income. As such, tax concessions need to target those who are to be part or full pensioners.

Alternative 4 offers a design that increases government revenue, increases contributions and levels the playing field between income levels. The design ensures that tax revenue is captured up front, which is far more reliable because during retirement, superannuation is open to lump sum withdrawals and thus not all balances are assessed against the income and assets test. This will especially be the case in the future where there is a high risk that generation x and y will access super to pay down their high debt.

Alternative 3 is the obvious choice if government wish to change superannuation, but alternative 4 has been offered as a different way when integrated with a tax system if contributions and deductions were from the bottom up.

Age Pension

The recent GFC has left a great debt, and thus the pain needs to be shared. Lower interest rates to improve the economy, means housing affordability has gone backwards for younger people. Older Australians prosper with house price increases that are neither taxed or means tested. Yet they rely on younger taxpayers to support them in the pension phase.

Given that the number of taxpayers to pensioners is to fall from about 4.5 to 2.7, this is clearly unfair on those who support pensioners, especially those who can support themselves partially or fully.

Assets and Income Test

Family Home

The family home should be included in the asses test now.

The National Commission of Audit recommended that $500,000 for single homeowner and $750,000 combined for coupled pensioners. But this would apply from 2027-28 onwards and only to new recipients of the age pension.

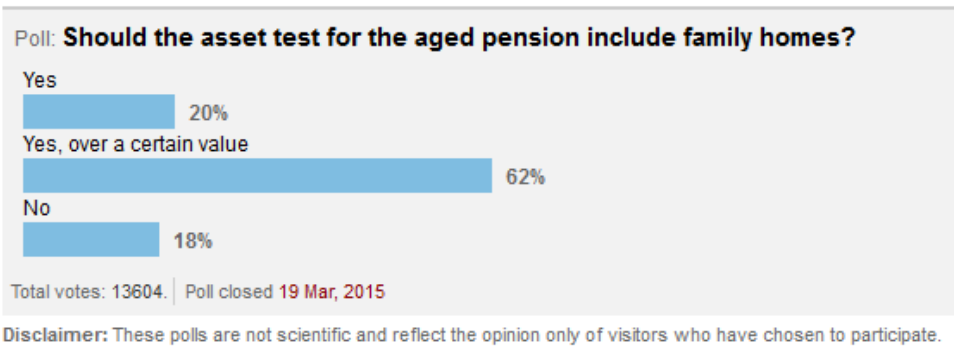
These rates should be determined for a 2027-28 value and applied now. For example $500,000 escalated at 5% per annum is $900,000. This amount then should be fixed until the $500,000 increases and meets this amount into the future.

But the reason that they should be brought forward is that record low interest rates have brought forward home prices, and thus a wealth transfer from the current taxpayers who wish to buy their first home, to current home owners such as pensioners. Several hundred thousand dollars in home value has been created and is not being utilised.

Figure 6 is a poll from the *Sydney Morning Herald* 12/13 March 2015, about whether the family home should be included in the assets test.

http://www.smh.com.au/business/the-economy/people-with-10m-homes-shouldnt-get-the-age-pension-says-former-government-adviser-john-freebairn-20150312-1427y1.html#poll

Figure 6 – Screenprint of a poll by the Sydney Morning Herald on including the family home in the assets test.



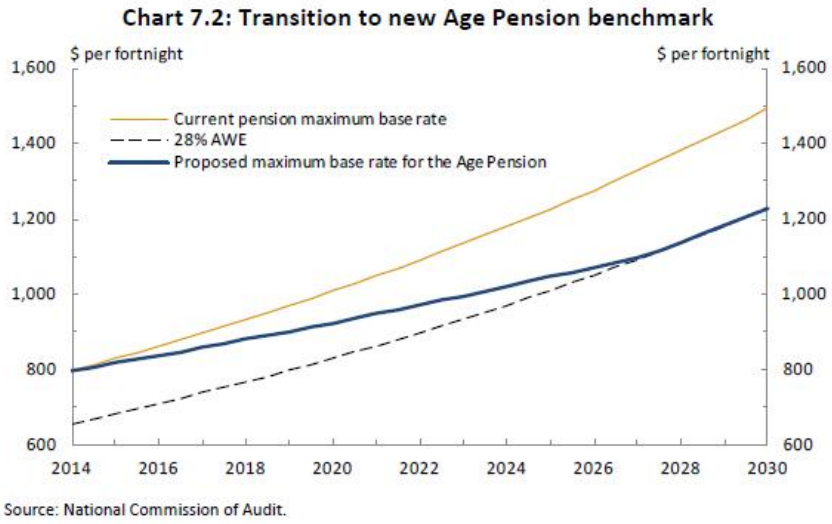
Of the 13,604 polled, 82% said yes that the family home be included in the assets test. Only 18% said no. The majority said that yes, over a certain value. Hence the National Commission of Audits

recommendations are probably well balanced. Though people's viewpoint I suspect is that they should be included now, not in 2027. Pensioners who are assessed for the principal residence should not have their pension payment reduced, instead government should take it as a future debt to be repaid upon death.

Amount of Pension

I disagree with the NCOA recommendations in figure 7 that the pension be benchmarked to Average Weekly Earnings. The current arrangements should still stand. Instead the principal residence should be included as an alternative for cost savings along with better targeting of part pensions especially those in the second half of the part pension.

Figure 7 – National Commission of Audit suggested design for age pension payments.



Source: National Commission of Audit.