Submission to Re:think on Taxation

I wish to discuss a number of issues relating to Superannuation (items 1(a) to 1(f), the loss of the Net Medical Expenses Tax Offset (Item 2) removed by the last ALP government budget and has not been not reinstated by the current government and the final item is the introduction of a Financial Transaction Tax (FTT) (Item 3.).

1(a). Tax free pensions from superfunds

Joe Hockey and the Prime Minister's comments that "Super is their money" and he doesn't want to take it off them is pretty stupid. Money going into Super is no different to money I put in the bank which earns interest is then taxed again even though I have already paid tax on that money. Similarly if I invest in shares outside of Super it is with money that I have paid tax on and is then any income is taxed again so again Government's comment makes no sense. In addition the tax revenue lost by salary sacrificing into super by the wealthy, is basically revenue lost to the lower income population to support, health, education, infrastructure via spending by the C/W government. So in this regard it is not "their money" as suggested by both Joe Hockey and the Prime Minister but the Nation's money.

Since Peter Costello introduced the concept of tax-free pensions from superfunds, I have written many times to both the former ALP governments and the current one about how iniquitous the current system is. When it was originally introduced I wrote to my local MP pointing out that there would now be three different types of tax-payers: (a) workers who pay normal tax and are trying to buy a house and bring up a family; (b) retirees on defined benefit schemes who pay tax on their pension but are given a tax offset of 10% of their pension; and (c) retirees with 'fully-funded' superfunds that would pay no tax. Their pension income is classed as non-assessable, non-exempt (NANE) and does not need to be reported to the ATO.

1(b). NANE pensions

The result of a pension being NANE income means that there is no taxable income and it does not need to be reported to the ATO on a Tax Return; secondly with no taxable income no Medicare levy is paid as it is based on taxable income not NANE income; and until the last budget all pensioners with NANE income, irrespective of the income, got access to the Senior's Health Card with its associated benefits. Whilst other retirees lose the SHC at $50,000 income per person or $80,000 as a couple, a person or couple with a NANE income pension can still get the SHC even if their pension is $250,000!

There are some SMSFs which are nearly $100million meaning their tax free pension would be $5million and still they would still pay no Medicare or NDIS. In each case, the Medicare lost by the government would be $100,000. How these funds got to $100million I will address later. They certainly couldn't get there by the $35,000 contribution limits or the $450,000 after tax contribution limits in 3yrs.

According to APRA/ATO, there are >12,000 SMSFs with >$5million which means their tax free pension is >$250,000 p.a. and again no Medicare/NDIS is paid and for existing pensions (pre last budget), the recipients will still get the Seniors Health Card. Even within my golfing circle of 120 golfers I know of 5 people whose pensions are ~ $250,000 and they pay no tax, no Medicare and retained the SHC due to the grandfathering in the 2014 budget.

It gets even worse than the above because with the pension being tax-free (NANE) the recipients still have the $18,200 tax free entitlement which means they could have investments of $365,000 earning 5% outside of Super and still pay no tax or Medicare.

Retirees with large NANE pensions pay nothing towards the Commonwealth government for the services that it provides, particularly health were they are likely to be heavy users of health facilities – cataracts, hearing aids, joint replacements, heart surgery etc. The whole system stinks of a rort for the super wealthy.

If Peter Costello did not understand the likely future outcome of tax free pensions or the Dept of Treasury or Finance did not warn him of these outcomes then it is a sad reflection of the policy development by government. If Peter Costello was aware that the new system would advantage the wealthy and superwealthy at the expense of those on low incomes then it is a sad indictment on the Howard & Costello government. It is also a sad indictment on the Rudd, Gillard, Rudd governments for not overturning the tax free pension scheme in favour of a more equitable one (see my solution below).

1(c). Estimated revenue lost

Even in the 2009 budget it was estimated that the Age Pension would cost $27 billion and rising as the population aged and fewer workers were supporting more retirees. At the same time the tax concessions in superannuation were aleady a tax revenue loss of $25 billion (much larger now). In other words the tax concessions to the wealthy and super-wealthy retirees would easily have funded the age-pension to the less well off.

All tax-free pensions should be reported to the ATO; the pension should be added to the Adjusted Taxable Income (ATI); Medicare and NDIS should be paid on the basis of the ATI; there could be a tax offset equivalent to the tax paid at a 30% level; income above that level should be taxed at the normal marginal levels.

1(d). Borrowing by SMSFs

No, it's not a loophole in superannuation rules, it's a door the ATO, to the shock of the industry, opened a few years back. With this option, it was obvious that financial advisers would recommend to their the super wealthy clients how to make use of this option by the establishment of a naked trust outside of the SMSF which would then lend money to the SMSF at miniscule interest rates. That's probably what's happened on this occasion with the SMSF's that are $50-$100 million in size.

In essence, the concern is this: SMSF trustees are lending money to their SMSFs, but charging a low 0%-2% interest rate. This means that the SMSF is paying minimal interest back to the naked trust whilst at the same investing in high yielding overseas shares giving the SMSF ~ 50% profit this year as a result of the falling A/US and the gains on the US stock market. There is no need for these individuals to look for low tax havens in Bahamas, Ireland, Switzerland etc for their non-super money because the superfund only pays the trust back at 0-2% thus saving a massive tax bill on say the earnings of $20million invested outside of super. More of their money is retained in the low-tax environment that is super and not paying tax outside. The allegation is that this is a "well known" strategy in SMSF circles that allows wealthy Australians to get around the strict contribution laws, which limit members to contributing no more than $35,000 a year (less if you're below 60 years old) in concessional contributions and $150,000 in non-concessional contributions. If they are already maxing out on those limits, then having a 0% interest loan in place are they effectively making de-facto contributions beyond those limits? If they are only a few years off retirement they know that once retired and the SMSF is in pension mode, the fund will pay no tax on income or capital gains and the pension or any lump-sum drawn out will be tax free. As a result the gains made from the money lent to the superfund is then returned tax free.

1(e). One superannuation pension role of superannuation, solution

The ALP has suggested that income over $75,000 earned by a superfund in pension mode should be taxed. **THIS IS NOT THE ANSWER!** This would still leave untaxed pensions, no Medicare levy being paid and many still getting the Senior's health Card. In addition, this year even small superfunds with ~$700,000 might be hit with an earnings tax as many managed funds have achieved returns in excess of 15%. Of course if the retirees leave 100% of their superfund in cash then the superfund would not have made a return as big as the pension drawn out and with such a conservative investment strategy they may well run out of pension from the superfund and fall back on the Age Pension. With most people now having some super, it is time to educate them on how to run a superfund in pension phase. One solution is to have 1 yr's pension in cash, the 2nd yr's pension in higher return term deposits and then the remainder of the superfund in some balanced fund and even some in a more aggressive growth fund. This strategy would see most funds ride out another GFC.

The simple solution to the rorts for the wealthy and superwealthy with multimillion dollar superfunds is to limit the tax free pension to AWOTE or some similar figure based on the 30% tax rate and for all pension income above that to be taxed at normal tax rates. This would be achieved by applying a Tax offset on the pension income equivalent to the tax that would be paid at AWOTE or alternatively a tax offset equivalent to the tax paid at the 30% level. All the pension income would be included on a tax return along with any other income from outside of super – this would constitute their gross income. The payment of Medicare would be based on their gross income after allowing for deductions for charities, tax consultants etc. The eligibility for the Senior's Health card would be based on the gross income – this would see many wealthy retirees lose the SHC. The current grandfathering of the Senior's Health Card should be abandoned – it is unfair on those who have already lost the SHC due to the SHC not being indexed for 10yrs. After all, many of us were in receipt of the SHC for many years and simply due to our pensions being indexed by CPI and the SHC $50,000 limit not being altered in 10 years we eventually lost the SHC and now that it is being indexed by CPI we will never get it back.

In addition, by counting the pension as income with a tax offset, the $18,200 tax free limit would be used up by the pension received so that all other income earned outside of Super would be taxed at their marginal rate – this does not happen at the moment. People can be in receipt of $250,000 pensions from $5million superfunds and still earn another $18,200 income outside of Super without paying any tax or Medicare.

1(f). Role of Superannuation

When compulsory superannuation was brought in, it was intended, over time, to take many people off the Age Pension. It was not intended, or shouldn't have been, a method of investing large amounts of money by the superwealthy in low tax environments. The Government should calculate what a reasonable amount of superannuation is need to provide a reasonable standard of life when retired. Most financial advisers argue that this figure is between $1-2million for a couple. This would allow retirees to take a holiday, replace their car and meet ever increasing health costs. Superfunds that in the range $5 – 100 million, and there a quite a few according to APRA & ATO are well in excess of what is required to retire on and the excess pensions from these funds should pay tax and be required to pay Medicare. Borrowing by the superfund should be banned. The existing 15% contribution tax, 15% earnings tax and 10% capital gains tax on superfunds in accumulation phase should remain. Once a superfund reaches a certain limit (to be determined by a financial committee) then the taxes could be doubled thus making it much less favourable to the wealthy and superwealthy.

2. Net medical expenses tax offset

In the discussion on the $7 medical co-payment, no-one worried about people who were not bulked billed. 20% are not bulk-billed and my GP has raised the cost of a visit to $85, my refund is $37.08 so I am $48 out of pocket each time I see my GP. The ALP and Greens screamed blue murder about a $7 co-payment and yet most people could afford $7 and only those on pension cards needs to protected. Further the ALP and Libs have frozen the Medicare rebate until 2018 by which time my GP will probably be charging $100/visit so I will be $63 out of pocket for each visit. As part of the Libs co-payment they were even going to reduce the Medicare refund by $5 but no-one seemed to be worried about people who were not bulked-billed.

In the last budget of the ALP government, the ALP in its wisdom or stupidity scrapped the Net Medical Expenses Tax Offset so that last year, even after paying $1000 in Meicare levy and $1600 to Medibank, I was still $9000 out of pocket. This amounted to 17% of my CSS and deceased spouse's CSS pension. As a matter of priority the **net medical expenses tax offset** should be brought back.

The current government want people to have Private Health insurance as well as paying Medicare but the out-of-pocket expenses are becoming a large proportion of retiree's income. Eventually with increasing costs one will have to fall back on Public Health hospitals. The Net Medical Expenses Tax Offset, helped keep the costs down from major operations – knees and hips, heart surgery etc.

<u>3. Introduction of a Financial Transaction Tax (FTT)</u>

In the 2014 and 2015 budgets, the Government has sought to reduce the deficit by only cutting services – it has made no attempt to raise income from other taxes. This seems to be an anathema to the Government. A Financial Transaction Tax of 0.05% could be introduced which would hardly be noticed by the average person. If I spent all of my pension income I might pay $25 FTT p.a. Suppose we levied 0.05% on all financial transactions - there used to be one called FID which was scrapped quite a few years ago. On share transactions alone, at 0.05% it would generate $600million/year based on share transactions of $4.5billion transactions/day and 250 trading days p.a.. For the average shareholder it would add $5 to a $10,000 buy or sell - not much really especially if you are not a trader and also well within the difference between fees charged by brokers. It might however slow down the High Frequency Trading (HFT) systems which are distorting the stockmarket for other investors. HFT traders buy and sell in milliseconds and have access to company information via announcements in milliseconds – well before a normal investor. This in itself could be regarded as insider trading by HFT traders as the information is not available to everyone at the same time. A FTT would generate a lot of tax income in a short period of time.

A much larger amount of money would be generated from the FOREX market which exceeds the turnover on the stockmarket by a huge amount - maybe 100 times bigger. On that basis one might generate an extra $50billion revenue/annum. The current deficit would be gone in a couple of years!

One could also levy a higher FTT rate on international transactions which would get money from companies that try to minimise their Australian tax by sending money to tax havens. It would also provide a path to where the money is going because the FTT would be levied on a transaction between Bank A in Australia and Bank B somewhere else in the World. A Financial transaction tax (FTT) similar to the old FID, would generate nearly enough money to wipe out our supposed deficit without hurting the average man/woman in the street - the effect on their day to day transactions would be minimal.