Tax discussion paper submission

May 2015

The Association of Superannuation Funds of Australia (ASFA)

Contents

Executive summary **3**

Key findings **6**

Recommendations **7**

Objectives of superannuation **8**
- Primary objective
- Subsidiary objectives
- Principles of the system
- Principles of the tax system

Section 1: Adequacy **13**
- The role of tax concessions in achieving greater adequacy of retirement incomes
- Low Income Superannuation Contribution scheme

Section 2: Equity **16**
- Is the system equitable?
- Very high superannuation balances, equity and sustainability
- Broken work patterns and superannuation tax concessions
- Preservation age
- Early access
- Older Australians and workforce participation

Section 3: Superannuation and its interactions with other aspects of the tax system **23**
- Changes in the taxation of other savings vehicles
- Changes in the taxation of capital gains tax and dividend imputation
- Stamp duty on life insurance
- Different life insurance stamp duty treatment across the states and territories

Section 4: Improving the care and maintenance of the system **25**
- Superannuation and the Australian Taxation Office
- Enhancing the benefits of SuperStream

Section 5: Superannuation, the budget and the economy **28**
- Sustainability: the budget cost of tax concessions in superannuation
- Superannuation reduces the cost of retirement policy
- Superannuation improves the national saving rate
- Superannuation reduces reliance on foreign capital
- Household balance sheet diversification
- Patient capital for alternate asset classes

Appendices **34**
- Appendix 1: Measuring the performance of the superannuation and retirement system
- Appendix 2: Measure of adequacy
- Appendix 3: Income stream tax option
- Appendix 4: Policy options to address broken work patterns
- Appendix 5: Dividend imputation
- Appendix 6: Stamp duty on life insurance
- Appendix 7: *Mythbusting superannuation tax concessions*

Executive summary

ASFA congratulates the government on instigating the tax white paper process, and while ASFA's submission does focus on the retirement incomes industry, we support a holistic review of Australia's taxation system. Superannuation has a unique and central role for Australians and the Australian economy. Superannuation funds under management have grown from $140 billion in 1992 to $2 trillion today. As a result:

- Australia is better prepared to deal with an ageing population than most, if not all, developed countries;
- Despite the system not yet being mature, the cost of the Age Pension to the Federal Budget is already being substantially reduced by $7 billion per year and growing;
- Australia's savings rate has increased, providing a domestic pool of capital, reducing reliance on international capital markets and lowering the cost of investment; and
- The investments Australians hold are now more diversified through the professional management of savings in superannuation.

The tax treatment of superannuation has impacts, not just on the retirement incomes of all Australians, but on the economy as a whole. Any changes to taxes that affect superannuation need to be considered in the context of:

- the retirement adequacy impact on individuals
- the relationship of superannuation with the Age Pension system
- flight to other savings vehicles
- the budget and the economy.

The objective of Australia's superannuation system should be the starting point for reviewing the tax treatment of superannuation.

While more work needs to be done to finalise and enshrine the objective and goals of superannuation, the objective outlined in the Financial System Inquiry (FSI) final report provides the first filter for the tax treatment of superannuation. That objective is:

> ***"To provide income in retirement to substitute or supplement the Age Pension."***

In addition to this, several key principles should be applied to review any tax changes:

- adequacy
- equity
- sustainability
- simplicity.

As well, any change should not undermine confidence in the system as this affects the likelihood of achieving the objective.

Against the objective of superannuation, under the current tax arrangements, superannuation is delivering on improving adequacy, achieving equity, sustainability, simplicity and maintaining confidence in the system. Additional increases to the rate of the Superannuation Guarantee (SG) and coverage across all working people would further improve the ability of the system to provide an income in retirement to substitute or supplement the Age Pension.

Without compulsory superannuation, around 50 per cent of couples and over 70 per cent of single persons would have incomes in retirement no greater than a $1,000 or so a year in addition to the Age Pension. To live comfortably, the minimum a couple needs is $58,444 per year, and the Age Pension alone does not deliver this.

With compulsory superannuation a single person who is on average earnings of $70,000 per year will retire with around $425,000 in today's dollars and have an income in retirement which would be nearly 90 per cent higher than that provided by the Age Pension alone.

The current tax expenditure statement states that the cost to the budget of superannuation tax concessions is around $30 billion per annum. However, when the savings the government makes on the Age Pension as a result of superannuation are take into account, together with the potential impact of behavioural change (people shifting money from a less tax-effective vehicle to a more tax-effective one) that would occur if superannuation tax concessions were removed, a more accurate estimate would be around $16 billion a year.

Given superannuation is already substantially delivering against the objective and principles underpinning the system, any change should be measured and consider how it relates to the key principles and confidence in the system.

ASFA has identified two main areas for reform that are consistent with the key principles and ensuring confidence in the system which we believe should be considered by the tax white paper secretariat.

Many levers can be pulled, which will no doubt be considered throughout the tax white paper process. However, this paper focuses on how the design of the system fits its purpose. That is to ensure the right people get the right level of assistance to achieve the purpose of the system.

1. Equity – sound design of the system

Equity is an important part of the sound design of a retirement incomes system. The Australian system is underpinned by tax concessions, which means that taxpayer value for those tax concessions must be broadly equitable. A good way to ensure equity is to place a ceiling on those taxpayer funded concessions. In determining the ceiling, we need to look at the purpose of the system and ensure that the system is not used for other purposes. ASFA considers that the superannuation system should not be used for the purpose of estate planning, and that to fulfil the purpose of the system, account balances should be close to zero on death, taking into account normal longevity.

In essence, this means that there should be a ceiling on where the system should stop providing taxpayer support for accumulating retirement savings or supporting incomes in retirement. On analysis, it is ASFA's view that the ceiling today should be above $2.5 million; this ceiling may be raised over time. It is important to note that the vast majority of members do and will use the system for its intended purpose. However, there is a small minority of people that can use the system for estate planning and unless the system design is changed slightly, then an even greater proportion will fall into this category in the future. The main suggested changes to ensure equity in the longer term are to reduce the non-concessional caps and tax very high account balances differently.

Accordingly, there is a strong reason to support a more detailed review of these types of balances:

- Around 475 people in pension phase have balances of $10 million or more
- The average income stream for these individuals is $1.5 million a year which is tax free
- Around 70,000 people have balances of over $2.5 million
- The income streams these individuals achieve considerably exceed the ASFA estimate for a comfortable retirement of $58,264 and exceed, in terms of tax concessions, what is a reasonable rate of income replacement in retirement.

ASFA is recommending that a limit of $2.5 million be placed on the superannuation funds an individual can roll-over to commence an income stream in retirement. Amounts above this ceiling must remain in the accumulation phase and continue to attract the nominal earnings tax of 15 per cent or be removed from superannuation. Non-concessional contributions should also be capped at $1 million over a lifetime to prevent very large balances from accruing in the future as an integrity measure to complement the $2.5 million capital cap.

These two measures will improve the equity, sustainability and confidence in the superannuation system.

2. Adequacy – broken work patterns

An issue of concern is the capacity of individuals with broken work patterns to make "catch up" concessional contributions. The concessional contribution caps generally do not enable those individuals to make sufficient additional contributions to save enough for retirement.

A significant number of people experience broken working patterns, with time out of the paid workforce for reasons such as the provision of care-giving (be it children or other family members), to study or as a result of unemployment or underemployment.
Women frequently experience broken working patterns and, as a result, the average superannuation balance of women is significantly lower than the average balance of men. This is exacerbated by the fact that the average income of women is significantly lower than that of men and by the increased prevalence of women in part-time and casual employment.

The average superannuation balances at the time of retirement in 2011-12 was of the order of $197,000 for men and $105,000 for women.

ASFA is recommending that concessional contribution caps should be changed in such a way that individuals with broken work patterns are able to make sufficient contributions. Accordingly, we recommend that this is a significant issue which should be considered in the Green Paper.

An important policy to assist those with broken work patterns is the SG increase to 12 per cent which, in combination with changes to the concessional cap, would improve superannuation balances and adequacy.

Dividend imputation

The inclusion of all aspects of the Australian tax system is a welcome and important aspect of the tax white paper process. Given the impact that changes to the relative tax treatment of one savings vehicle will have on others in the economy, examination of these issues in the tax white paper process needs also to consider how such changes interact with superannuation.

ASFA has undertaken research on the role of dividend imputation in superannuation and makes a key finding that removal of dividend imputation would have a negative impact on superannuation by reducing incomes in retirement by $4,000 on average.

Care and maintenance of the superannuation system

ASFA also considers that, as the tax consultation process develops, there should be a consideration of 'care and maintenance' issues in the system. Care and maintenance issues include whether legislation is consistent and accurately reflects policy and/or whether the underlying policy intent is still applicable in the current environment. ASFA is undertaking further work on identifying some of these 'care and maintenance' issues and we will engage further as the tax process continues.

Key findings

Under the current tax arrangements, superannuation is broadly achieving its primary objective.

- This will be supported further by increasing the SG rate from 9.5 per cent to 12 per cent and continuing the Low Income Superannuation Contribution (LISC).
- Any change to the system should not undermine the importance of ensuring adequacy for individuals.

An appropriate ceiling for the current full tax concessions in superannuation to ensure the system meets its purpose is $2.5 million.

Further work needs to be undertaken to evaluate methods for improving flexibility in superannuation to allow individuals with broken work patterns to be able to make "catch-up" contributions so as to achieve a higher income in retirement.

Removal of dividend imputation would have a negative impact on superannuation, reducing incomes in retirement by $4,000 on average.

The cost of superannuation tax concessions to the government is substantially lower than that reported in the tax expenditure statement.

Tax concessions in superannuation, by encouraging voluntary contributions to superannuation, are reducing the cost of the Age Pension.

Superannuation has contributed to a higher level of savings than would otherwise be the case which:

- has reduced the cost of capital in Australia and had a positive impact on economic growth; and
- assisted Australian companies to refinance during the recent financial crisis when international capital was scarce.

Superannuation has contributed to broader and more risk appropriate investment by individuals and the professional investment of savings through superannuation has had a positive impact on economic growth.

The tax treatment of superannuation by encouraging voluntary contributions, has contributed to the creation of pool of capital which is available for long-run investment such as infrastructure and start-ups that would not otherwise exist. This has had a positive impact on economic growth.

Recommendations

The objective and principles of superannuation should be considered as the basis for evaluating any proposed changes to the tax treatment of superannuation.

Changes to the tax treatment of superannuation need to be considered in the context of the full retirement incomes system. Changes to the Age Pension also need to be considered in the context of their impact on superannuation.

The current system design should be adjusted so that it only delivers on its purpose to substitute or supplement the Age Pension.

The Review Secretariat should:

- consider options to limit the tax concessions for those with very high superannuation balances in retirement; and
- consider a capital cap.

The Review Secretariat should consider options to limit non-concessional contributions caps to increase equity in the system, including consideration of a $1 million lifetime non-concessional contributions cap.

The superannuation preservation age should be set five years younger than the Age Pension age, up to a maximum of 62.

Access to a limited income stream should be available from age 60 for:

- those who have been unemployed for a specific period of time
- those seeking to retrain
- Indigenous Australians
- those employed for 20 years or more in specified professions.

Stamp duty on life insurance should be abolished.

As the tax discussion process continues, there needs to be further consideration of care and maintenance issues.

The Australian Taxation Office (ATO) should be tasked to consolidate, on an individual taxpayer basis, information from annual Member Contributions Statements (MCS) and use that information to prepare an amalgamated superannuation balance statement for inclusion with the notice of assessment of each taxpayer following the lodgement of their annual income tax return.

Additional funding should be devoted by the ATO to respond to employee complaints about non-payment of superannuation contributions and to improve the level of SG compliance generally.

The government should work with the industry to establish a mechanism for funding the Gateway Network Governance Body (GNGB).

Objectives of superannuation

To evaluate the impact of the current tax settings within superannuation it is necessary for there to be a clear objective of the system. It is also necessary for quantifiable goals to be set to determine if this objective is being met. Finally, a set of principles is required against which to evaluate proposed changes to superannuation. The FSI has made recommendations on the objective of superannuation and this provides a goal against which the Tax Green Paper can consider the current tax settings in superannuation and any potential changes.

Primary objective

Recommendation 9 of the FSI Final Report proposed that broad agreement be sought with respect to the objectives of the superannuation system. It recommended that these objectives be enshrined in legislation and that there be public reporting on how policy proposals are consistent with achieving those objectives over the long term.

The FSI Report proposed that the primary objective of the system should be:

> ***"To provide income in retirement to substitute or supplement the Age Pension."***

ASFA supports this proposed primary objective for the superannuation system. In particular, ASFA supports the assertion that the overriding purpose of superannuation is to provide people with an income in retirement.

ASFA also supports the inclusion of a reference to the Age Pension in the statement of primary purpose. Although superannuation is unlikely ever to replace the Age Pension for every Australian, ASFA considers it important to the primary purpose of the retirement system, since both superannuation and the Age Pension are intrinsically linked and are essential components of Australia's retirement infrastructure.

Subsidiary objectives

The FSI Report also recommended that the government seek broad agreement on the subsidiary objectives of the superannuation system, namely to:

- facilitate consumption smoothing over the course of an individual's life
- help people manage financial risks in retirement
- be fully funded from savings
- be invested in the best interests of superannuation fund members
- alleviate fiscal pressures on government from the Age Pension
- be simple and efficient, and provide safeguards.

ASFA supports these subsidiary objectives and has recommended that a discussion on how and where they should be enshrined in a legislative framework should commence as soon as is practically possible.

Implementing the FSI recommendation alone, however, will not be enough to ensure success. In order to succeed, we will need to do more than simply enshrine the objectives in legislation and require public reporting as to the extent to which future policy proposals are consistent with these objectives. While both these initiatives will assist in developing a truly efficient superannuation system, to ensure success the superannuation industry will also need to agree appropriate and tangible measures of success and to monitor the system's progress against these measures.

In Appendix 1, we discuss some of the potential metrics which ASFA believes could be appropriate markers for measuring the performance of the superannuation and Age Pension systems and which could form the basis for reviewing the tax treatment of superannuation over the long term.

Principles of the system

Over the past decade or more the retirement system has been subject to incremental changes and a significant degree of policy inconsistency. This has been a source of considerable confusion in the community and has reduced people's confidence in the stability and reliability of the system. Given that superannuation is a long-term investment, subject to preservation, ensuring consumer confidence is critically important.

In order to create an environment for improved consistency in policy decision making it is necessary to define the underlying policy principles on which the system should be based. The overarching objective should be to design a system that delivers the best outcomes for fund members within the fiscal constraints of government.

ASFA believes the following principles should underpin retirement income policy decisions including changes to tax settings affecting superannuation.

Principle 1: Adequacy

Retirement incomes policy should be designed to ensure as many people as reasonably possible have an adequate income in retirement.

The purpose of having a retirement income policy should be to ensure that as many people as reasonably possible have an adequate income in retirement. The goal is to minimise the number of retirees living in poverty or relative poverty, and maximise the number living in comfort and with dignity.

Numerous pieces of research have shown that even a modest increase in income in retirement can result in significant improvements in retiree satisfaction. Analysis of the results of an investment trends survey found that, in retirement, every $5,000 increase in annual income has an impact on quality of life. In particular:

- those on $20,000 per annum felt they struggled to make ends meet
- those on $25,000 per annum felt they were just getting by
- those on $30,000 per annum felt they had a little left over
- those on $40,000 per annum felt were able to live comfortably.

A superannuation-sourced income stream of only $5,000 per annum can boost a retiree's income by 25 per cent compared to the Age Pension alone. This can have a significant positive impact on their standard of living.

As a minimum, ASFA has identified that a lump sum of $510,000 will provide enough income in retirement (around $58,000 a year) to support a comfortable (but basic) lifestyle in retirement. This assumes the receipt of some part-pension, that the member owns their own home and does not include the increasing health and aged care costs as members age. The ASFA standard is the minimum level of adequacy that the retirement system should provide.

Principle 2: Universality

The retirement income system must be comprehensive in its coverage.

The retirement income system must be comprehensive, covering people in different types of employment structures – for example, employees, contractors and the self-employed. It must also cater for members at every stage in the employment lifecycle and at all levels of income.

Australia's retirement income system must be focused on the ability of each Australian to be able to accumulate adequate retirement savings.

Principle 3: Equity

The retirement income system must be equitable in its outcomes. Equity has two aspects – intra-generational equity and inter-generational equity. For superannuation, this means its taxation should reflect the principles of a progressive tax system.

Equity has two aspects – intra-generational equity and inter-generational equity.

To achieve intra-generational equity requires individuals of the same generation to be treated fairly, after taking into account different levels of income and net worth. All other things being equal, in a progressive taxation system it is generally considered equitable if those on higher incomes or net worth contribute proportionally more in tax revenue than those on lower incomes or net worth.

Inter-generational equity describes the burden or benefit one generation has compared with another. When it comes to making superannuation policy decisions consideration must be given to the impact on inter-generational equity. The Age Pension and other forms of social security and welfare (such as Medicare, provision of healthcare and other services and the maintenance of infrastructure) are funded by taxpayers, and a large proportion of this tax revenue comes from those in paid employment. Therefore, it is critical that the concessional tax treatment of superannuation does not impose too great a burden on future generations of employee taxpayers.

Furthermore, the fiscal costs of the retirement income system (including both tax concessions and Age Pension payments) must also be perceived to be equitable when assessed across all facets of the system, including the pre and post retirement phases. The community is sensitive to changes, so care should be taken to ensure changes do not undermine confidence in the system.

Principle 4: Simplicity

The retirement income system should be as simple as possible. Taking into consideration matters of equity and flexibility, there should be genuine simplicity in design, making the system easier to understand and to implement.

The superannuation system should be simple enough for people to understand, while ensuring it remains equitable and flexible enough to deliver the headline objective of the system. Undue and unnecessary complexity should be avoided as this comes at a cost, including the erosion of confidence in the system. Simplicity should be considered for superannuation fund members, superannuation funds and the government.

The retirement income system should also be flexible enough to take into account the varying patterns of work, lifetime income and expenditure that exist. Phased retirement should be encouraged as a means of assisting people to remain in the workforce longer.

Principle 5: Sustainability

The retirement income system must be sustainable. This means ensuring it delivers on its intended objectives within the fiscal constraints of government and takes into account declining taxpayer to retiree ratios, the impact of future Age Pension payments, the cost of the tax concessions and the tax burden faced by future taxpayers. Tax concessions should be limited appropriately.

The level of financial assistance for retirement provided by governments, and therefore by taxpayers, must be sustainable over the long term. This means taking into account demographic factors that contribute to fiscal outcomes, including the declining taxpayer to retiree ratios, declining fertility rates and increasing longevity.

By the time the majority of baby boomers have retired the ratio of employed taxpayers to retirees will have halved from around five at present, to less than three. While minimising reliance on the Age Pension is the underlying reason for the emphasis on self-funding for retirement, it is critical to ensure that future employed taxpayers do not bear an undue proportion of the general tax burden and that an equitable contribution is made by retirees to tax revenue.

When it comes to tax concessions the benefit to individuals of providing these must be assessed against the cost to taxpayers, and reasonable limits applied. Currently these are in the form of annual caps on concessional and non-concessional contributions. In future, to ensure that the sustainability of the system is maintained, it is imperative that a cost/benefit analysis is undertaken with respect to all proposed policy changes.

In particular, concessional tax or social security treatment which significantly favours one group over another, drives sub-optimal behaviours, or results in undue complexity or administrative burden, should be avoided or reconsidered.

It is important to ensure that there are sustainable and equitable tax settings in place for the superannuation system that provide certainty for people, regardless of their stage in life, to have confidence regarding their retirement savings plans.

Principle 6: Three-pillar policy

The three pillars of the retirement income system – the safety net of the Age Pension, mandatory Superannuation Guarantee (SG) contributions and voluntary savings, both inside and outside superannuation – should remain in place.

The three-pillar policy: safety net of the Age Pension, mandatory SG contributions and provision of tax incentives, such as the concessional tax treatment of superannuation to encourage voluntary savings, should remain in place.

The Age Pension must remain as a safety net for those individuals or families who earn below average wages, or who spend time out of the workforce (for example to raise a family or care for dependants, or because they are or disabled or unable to find employment), or incur a significant extraordinary expense or unanticipated depletion of assets. It is vital that these individuals continue to receive support from the government to achieve a basic income in retirement.

The second pillar, mandatory SG contributions, is critically important as it creates the pool of private savings required to help Australians fund all or part of their retirement. The third pillar, being the tax concessions applied to superannuation and other savings, also plays an important role in supporting members to contribute amounts above the SG towards their retirement savings.

The SG is what sets the Australian superannuation system apart from most other pension systems in the world. It has been critical to the success of the superannuation system – seeing it grow to $2 trillion as at the end of the March 2015 quarter. This is the fourth largest pool of managed funds globally – larger than the size of Australia’s economy by GDP – and makes a significant contribution to Australia’s economic growth and stability.

Principle 7: The system is about replacement income in retirement

The focus should be on providing income in retirement. Opportunities for accumulating excessive superannuation balances in a concessionally taxed environment, for example with a view to generational transfer, should be minimised.

This principle is consistent with the primary objective of the superannuation system proposed in the FSI Final Report, which ASFA strongly supports.

The superannuation system needs to be designed to deliver income streams in retirement. This means creating a regulatory environment that facilitates the development of a flexible range of products for retirees, better manages the transition-to-retirement phase, provides incentives for people to access income streams and implements tools that help move cultural attitudes away from a lump sum mentality towards income streams. For example, all member statements should contain a projection of the member’s likely income stream in retirement based on their current balance and level of contributions.

Principles of the tax system

There are implicit trade-offs when considering these principles in terms of tax policy design. However, given the objective of the system "To provide income in retirement to substitute or supplement the Age Pension" and the need to ensure changes do not undermine confidence in the system, ASFA considers that there should be a clear focus on adequacy and equity in any change to the system (along with sustainability and simplicity).

Recommendation

The objective and principles of superannuation should be considered as the basis for evaluating any proposed changes to the tax treatment of superannuation.

Recommendation

Changes to the tax treatment of superannuation need to be considered in the context of the full retirement incomes system. Changes to the Aged Pension also need to be considered in the context of their impact on superannuation.

Section 1: Adequacy

Given the primary objective of superannuation is to substitute for, or supplement, the Age Pension it is crucial that the tax treatment of superannuation supports adequate retirement incomes. It should provide an incentive for additional savings beyond the SG and not significantly erode superannuation balances. Any change to the tax settings needs to focus on this key principle of adequacy.

The role of tax concessions in achieving greater adequacy of retirement incomes

The notion that governments should provide assistance, particularly through tax concessions, for people to save money for their retirement is based on sound policy. Such assistance encourages people to save money to partially or fully self-fund their retirement and, in effect, compensates people for sacrificing income they could use today, in order to help ensure they have adequate income when they cease working.

Tax concessions therefore are a necessary part of our superannuation system, as they provide the incentives and assistance people need to save sufficient money for their retirement. While the Age Pension provides just enough income to avoid poverty in retirement, it does not in itself support dignity or adequacy in retirement.

Tax concessions for superannuation contributions, investment earnings and benefits play an important role in achieving adequacy of retirement incomes.

Firstly, concessional tax treatment of contributions, earnings and income streams in retirement, means that there is more being saved in the form of superannuation. This directly contributes to superannuation balances and means that there is a higher base for the compounding of investment earnings.

Secondly, concessional treatment of investment earnings within superannuation leads to a higher net investment return, which also boosts the final retirement balance. Around 70 per cent, on average, of a superannuation balance at the time of retirement is attributable to investment earnings, with the remainder attributable to contributions.

Thirdly, the various superannuation tax concessions encourage people to contribute more to superannuation, by way of salary sacrifice or non-concessional contributions. They also are an important driver for contributions by the self-employed, many of whom are not covered by compulsory superannuation contribution arrangements and may not take advantage of tax concessions on earnings.

Today, superannuation is boosting incomes and providing a lifestyle in retirement that is better than that which can be sustained on the Age Pension alone. In the broadest terms, superannuation is achieving its primary objective.

Without compulsory superannuation, around 50 per cent of couples and over 70 per cent of single persons would have incomes in retirement no greater than $1,000 or so a year in addition to the Age Pension. Based on the on the ASFA Retirement Standard, in order to live comfortably a couple needs a minimum of $58,444 per year, and the Age Pension alone does not deliver this. (Appendix 2 provides a detailed description and explanation of the ASFA Retirement Standard).

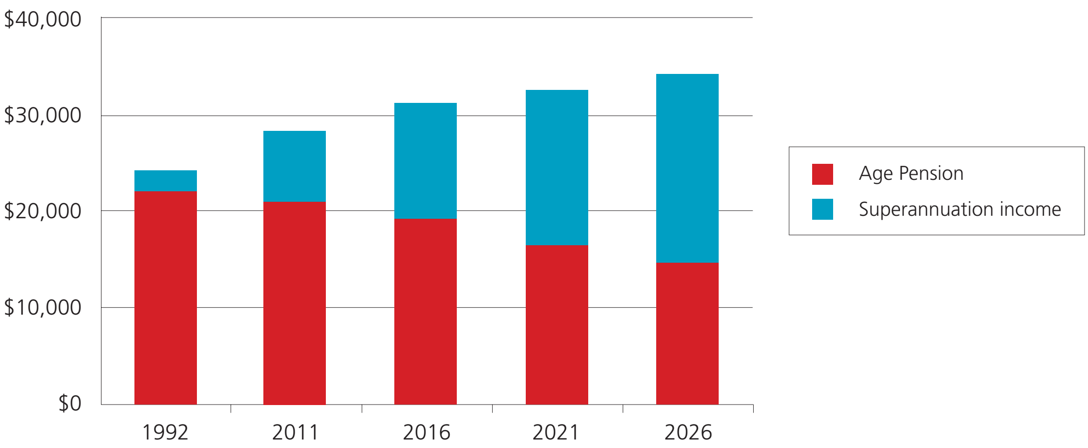
With compulsory superannuation a single person who is on average earnings of $70,000 a year will retire with around $425,000 in today's dollars and have an income in retirement which would be nearly 90 per cent higher than that provided by the Age Pension alone.

These benefits are likely to be even greater in the future as the SG increases to 12 per cent and more people have the benefit of savings and earnings sustained over a number of years.

As indicated in Figure 1 below, we project compulsory superannuation will increase average retirement incomes substantially over the years ahead. This is based on the current legislated assets tests for the Aged Pension. The government has proposed that the assets test be changed. This would alter the amount of Age Pension that is received by those who have assets above the new threshold.

Currently an individual with the average amount of superannuation will receive most of their retirement income from a part Age Pension. In 2026, an individual with the average amount of superannuation will see the majority of their retirement income coming from superannuation. In today's dollars the projected amounts are $14,770 a year from the Age Pension and $19,340 from superannuation. In essence, superannuation (assisted by tax concessions) leads to higher retirement incomes and lower government expenditure on the Age Pension.

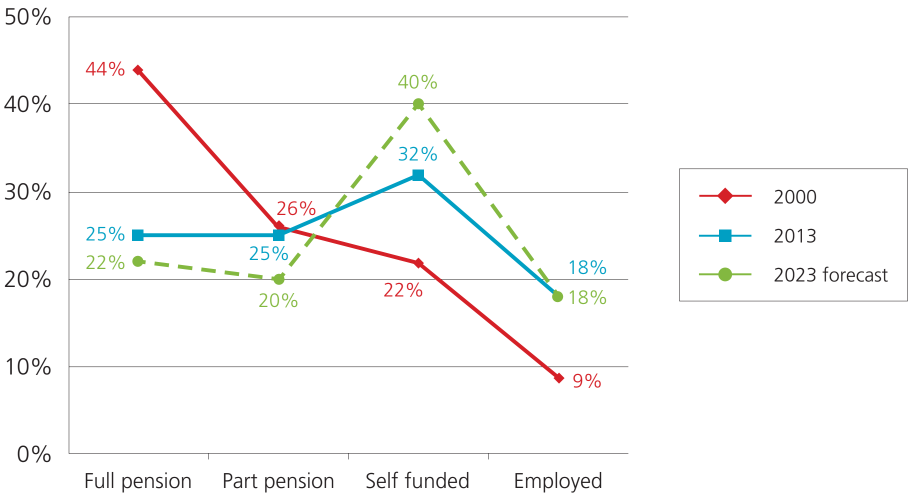
Figure 1: Average retirement income at age 65 (in today's dollars)



Many current retirees did not have the benefit of compulsory superannuation contributions for an extended period so it would be unrealistic to expect that people who retired up to 20 or 30 years ago will be less reliant on the Age Pension due to compulsory superannuation. However, the impact on younger retirees is already significant. Figures on the take-up of the Age Pension by specific age cohorts indicate that a substantial proportion of those currently aged 65 to 67 are fully self-funded. Around 32 per cent of those aged 65 in 2013 were fully self-funded in retirement, up from 22 per cent in 2000. However, at age 75, only 16 per cent of people were self-funded, not much different to the level in 2000.

Looking forward, the proportion of persons newly turning 66.5 in 2023 who will be self-funded (on the basis of current Age Pension means test settings) is projected by the ASFA Research Centre to be around 40 per cent. This reflects projected increases in average retirement savings balances. Of course, the overall proportion of retirees (who will range in age from 66.5 to over 100) who will be self-funded will be lower than this given the lower percentages of self-funded retirees in older age groups.

Figure 2: Retirees at age 65



Source: ASFA Research Centre, 2014.

Low Income Superannuation Contribution scheme

The Low Income Superannuation Contribution (LISC) scheme currently benefits 3.6 million Australians on low and modest incomes, including 2.1 million women. It benefits around 30 per cent of workers who in 2009-10 only received around 1.2 per cent of total superannuation tax concessions. The introduction of the LISC nearly doubled the amount of tax assistance for persons earning less than $37,000 a year.

For a person earning just $37,000 a year, aged 30 and retiring aged 65, if the LISC applied over their working life it would boost their superannuation balance, in today's dollars, by around 20 per cent, from $200,000 to $240,000.

ASFA considers that the LISC represents a sound long-term public policy in relation to superannuation and retirement incomes, especially given the financial implications of the ageing population.

Key findings

Under the current tax arrangements, superannuation is broadly achieving its primary objective.

This will be supported further by increasing the SG rate from 9.5 per cent to 12 per cent and continuing the LISC scheme.

Any change to the system should not undermine the importance of ensuring adequacy for individuals.

Section 2: Equity

The retirement income system should be equitable in its outcomes. Any change to the tax settings needs to focus on this key principle. In this context, financial assistance for retirement provided by the government should broadly be comparable across the personal income tax brackets. Any change to the tax settings needs to focus on this key principle of equitable outcomes.

Is the system equitable?

All Australians receive financial support for their retirement from the government through either the Age Pension, tax concessions to fund their retirement through superannuation, or a combination of both. When both of these forms of assistance are summed across a lifetime, all Australian receive around $300,000 across all tax brackets as a contribution by the government to their retirement. That is, everyone receives the same amount of assistance from the government – the only difference is the timing and vehicle through which it is delivered.

A lower-income person will receive this mostly in the form of the Age Pension, concessionally-taxed contributions, concessionally taxed earning, the LISC scheme (while it remains in place) and tax-free benefits, while a person in the top income tax bracket will receive it as tax concessions for superannuation. Many will receive a combination of all of these.

What is more, the amount of government assistance provided to individuals on very high income levels has been substantially reduced though lower caps for concessional contributions to superannuation. Table 1 provides a summary of distributions of tax concessions across income bands.

Table 1: Tax concessions for superannuation by income

Taxable income range	Marginal income tax rate	Tax concession on contributions ($m)	Tax concession on investment earnings during accumulation ($m)	Tax concession during pension phase ($m)	Value of tax concessions across accumulation, investment earnings during accumulation and pension phase ($m)	% share across all phases
$0 – $6,000	0%	260	0	0	260	0.1%
$6,001 – $37,000	15%	1,575	100	2,000	3,675	11.2%
$37,001 – $80,000	30%	5,025	4,300	1,400	10,725	32.7%
$80,001 – $180,000	38%	4,740	5,200	1,100	11,040	33.7%
$180,001+	47%	1,770	2,900	2,400	7,070	21.6%
Total		13,370	12,500	6,900	32,770	100%

Very high superannuation balances, equity and sustainability

While the tax concessions in superannuation are broadly equitable across different income levels, there is some intergenerational and intra-generational inequity when wealth distribution is considered.

Once a person has accumulated enough superannuation savings to generate an income that will fund a comfortable lifestyle in retirement (in terms of the ASFA Retirement Standard) or a reasonable replacement rate for higher income earners, it is arguable that they no longer need the same tax concessions in place to incentivise them to accumulate further savings and to support the achievement of adequate retirement income.

Beyond that point, it is possible to argue that the accumulation of superannuation becomes more about using the tax-advantaged status of superannuation to build wealth for estate planning purposes, as opposed to delivering an income stream that provides a comfortable retirement.

Around 70,000 people have superannuation balances in excess of $2.5 million. The bulk of Australia's population, around 8.1 million individuals, have, in contrast, superannuation under $100,000. This in total amounts to around $260 billion. This in part reflects the fact that everyone starts from a zero balance and therefore balances of younger people are typically low but grow over time.

There is a strong correlation, somewhat unsurprisingly, between a person's age and the size of their superannuation balance. For example, an account balance under $100,000 is relatively common for those aged under 35, with higher balances becoming more common for older age cohorts.

However, there are still significant numbers of individuals aged 50 and over with little to no superannuation at all. This is because many people in older age cohorts are likely never to have had superannuation or to have been in the compulsory system for only a relatively short part of their working lives.

There are some retirees receiving a tax-free income stream that is far in excess of the ASFA comfortable standard. The average income stream for the 475 persons in pension mode with account balances greater than $10 million was $1.5 million. In some age groups the average payments were higher, with 84 persons aged 60 to 64 with account balances over $10 million receiving income stream payments which averaged $3.26 million a year.

The means by which large balances have been accrued have been reduced. The ability to contribute up to $1 million in undeducted contributions into superannuation that applied between May 2006 and 30 June 2007 resulted in very significant contributions being made into superannuation during that period.

Over $56 billion in such member contributions were made during 2006-07, which was a significant increase on the trend level of member contributions of around $10 billion or $11 billion a year. For APRA-regulated funds the increase was proportionately smaller but larger in absolute terms, up from $33.3 billion to $95.2 billion.

As well, some individuals made large undeducted contributions during the period prior to 2007 when no contribution caps applied. While Reasonable Benefit Limits (RBLs) were in place they diminished the tax benefit rather than preventing large contributions. The abolition of the RBLs and the move to tax free benefits at age 60 and over conferred a significant tax benefit to holders of such accounts.

Ongoing non-concessional contributions also have played a role in the creation of high balance accounts. An individual currently is permitted to contribute $540,000 in non-concessional contributions every three years up until age 65. Further contributions can be made by small business owners who retire and rollover the proceeds of the sale of their business into superannuation, making use of the capital gains tax concessions available. Self-managed superannuation funds (SMSFs) received over $18 billion in non-concessional contributions in 2012-13.

ASFA's view is that there should be a ceiling where the system should stop providing taxpayer support for accumulating retirement savings or supporting incomes in retirement and the appropriate level in today's dollars is a balance of $2.5 million. It can be argued that tax concessions above this level contradict the equity and sustainability principles of superannuation. The $2.5 million cap is based on the following:

- a replacement rate for retirement income that is often used is 60 per cent of gross pre-retirement income[1]
- for a person with an income of $200,000 a year a reasonable upper limit for the provision of taxation concessions or other assistance is a drawdown of $120,000 per annum in retirement

[1] A 60 per cent gross replacement rate converts to a net replacement rate of over 80 per cent at a pre-retirement income of $100,000 a year and nearly 90 per cent at $150,000 a year given that superannuation benefits are tax free after age 60. While ASFA uses 60 per cent as a minimum, it is acknowledged that a range of between 60 and 70 per cent is often used.

- an income of $200,000 or below includes 90 per cent of the workforce
- $120,00 per annum is close to twice the ASFA Retirement Standard estimate for the income required for a 'comfortable' retirement
- using the minimum drawdown factor for a person aged 65 to 74 this would require a superannuation balance of $2.4 million if the person were to live to 90.

Many tax and related social security measures have an upper income or wealth limit for either paying less tax than the maximum rate, receiving the maximum benefit or receiving benefits at all. The $200,000 income level has been based on other upper limits and tax thresholds that apply. For example:

- the maximum income level at which employers are required to pay SG contributions is $197,720 a year
- the temporary 'Budget repair levy' cuts in on incomes over $180,000 a year, as does the top marginal personal income tax rate
- the base (most generous) tier for the health insurance rebate applies to those on $180,000 or less a year
- Family Tax Benefit B is payable where the primary income earner is on $150,000 a year.

Tight Federal Budgets and an ageing population mean that the tax concessions in superannuation need to be targeted closely to ensure that the system is delivering higher incomes in retirement for the largest number of people while at the same time reducing the cost of the Age Pension.

Key finding

An appropriate ceiling for the current full tax concessions in superannuation to ensure the system meets its purpose is a balance of $2.5 million.

Recommendation

The current system design should be adjusted so that it only delivers on its purpose to substitute or supplement the Age Pension.

A $2.5 million ceiling on tax concessions – "capital cap"

ASFA has actively considered a range of options to implement a $2.5 million cap on tax concessions. While equity and sustainability are key principles driving the need for reform, a third principle – simplicity – must be included when policy solutions are considered.

In this context, ASFA considers that a capital cap which would see balances above $2.5 million in the pension phase being taxed or removed from the system as being the most effective option.

ASFA considers that individuals should not be permitted to have total capital underlying an income stream in the pension phase in excess of $2.5 million. Amounts in excess of $2.5 million could be commuted and rolled back into the accumulation phase and therefore be subject to the nominal 15 per cent tax on investment earnings, or withdrawn from the system by the individual. The $2.5 million converted into an income stream would remain tax free. For example, on retirement, an individual with a balance of $3 million could convert $2.5 million into a retirement income stream which would attract no earnings or benefits tax, while the balance of $500,000 could remain in accumulation and attracting the 15 per cent earnings tax or be withdrawn.

Individuals who already have in excess of $2.5 million underlying income streams would be given a transitional period in which they could commute the excess balance in retirement phase and either rollover to the accumulation phase or be paid a lump sum benefit. The cap would apply to individual's balances not the joint balances of couples.

A capital cap policy such as this applies a ceiling to the tax concessions that accrue to very high superannuation balances, which improves the equity and sustainability of the superannuation system. Further consideration would need to be given as to how this policy would apply to defined benefit funds. Appendix 3 includes an option to target income streams (consistent with the need to limit tax concessions for those with very high superannuation balances).

Recommendation

The Review Secretariat should:

- consider options to limit the tax concessions for those with very high superannuation balances in retirement; and
- consider a capital cap.

Non-concessional contributions

Concessional and non-concessional contributions caps, together with higher tax on contributions made on behalf of individuals with income and superannuation contributions in excess of $300,000, have placed restrictions on the ability of individuals to accumulate very high account balances, at least on a prospective basis.

Individuals, however, are still able to contribute significant amounts to superannuation through non-concessional contributions which are capped at $540,000 every three years up until age 65. This is inconsistent with the principle of equity as those with high incomes and wealth have a greater capacity to contribute significant amounts of money post-tax and receive concessional tax treatment on earnings, sometimes for decades.

The amount of non-concessional contributions could be capped at $1 million per individual per lifetime. Once the cap were reached, no further non-concessional contributions could be made. This would reduce the capacity for very large balances to be built up in the future and is an integrity measure for to compliment the cap of $2.5 million.

Recommendation

The Review Secretariat should consider options to limit non-concessional contributions caps to increase equity in the system, including consideration of a $1 million lifetime non-concessional contributions cap.

Broken work patterns and superannuation tax concessions

Broken work patterns, and their impact on affected individuals' capacity to accumulate sufficient superannuation, are having a substantial effect on the adequacy and equity of the superannuation system.

A significant number of people experience broken working patterns, with time out of the paid workforce for reasons such as the provision of care-giving (be it children or other family members), to study or as a result of unemployment or underemployment. In addition to this there is an increasing trend towards the casualisation of the workforce, with a higher proportion of roles being part–time, casual or performed through a contracting or sub-contracting arrangement, as opposed to traditional engagement as a full-time employee.

People's income can vary from year-to-year. This may be as a result of:

- the nature of their occupation (for example primary producers experience considerable volatility in income depending on weather and market conditions; artists may sell an art work in one year which represents work performed over previous years)
- the form of their employment (for example casual employees whose hours of work vary)
- variables such as the payment of overtime, allowances or loadings.

Even in occupations with more regular income there classically is a pattern across a person's working life where initially income is relatively low, before rising gradually with experience, to peak somewhere in the person's 40s or 50s.

This is coupled with an expense cycle which is often the opposite. Initially expenses generally are quite high, including the repayment of HECS (HELP) debts; saving for a house deposit; servicing a mortgage and the costs of raising children. Frequently these expenses do not begin to abate until people are in their late 40s or 50s.

Women generally assume the role of primary caregiver, especially with respect to raising children, but also in caring for elderly or ill parents, and even siblings. As a result women experience broken working patterns more frequently and more extensively than men. This has led to the average superannuation balance of women being significantly lower than the average balance of men. This is exacerbated by the fact that the average income of women is significantly lower than that of men and by the increased prevalence of women in part-time and casual employment.

Average superannuation account balances were $82,615 for men and $44,866 for women in 2011-12 (including zero account superannuation accounts). For those with superannuation, the average balance for males was around $112,000 while for females it was around $68,600 (excluding zero balance superannuation accounts). The average superannuation balances at the time of retirement in 2011-12 was of the order of $197,000 for men and $105,000 for women.

The impact of broken work patterns on retirement incomes is an area where the current tax arrangements in superannuation do not meet the key principles of adequacy and equity.

Policy solutions to deal with broken work patterns are not simple. There are, however, options that could be considered and these can be found in Appendix 4.

Key finding

Further work needs to be undertaken to evaluate methods for improving flexibility in superannuation to allow individuals with broken work patterns to be able to make "catch-up" contributions so as to achieve a higher income in retirement.

Preservation age

Preservation age is an integral component of the retirement income system and the setting of preservation age has a significant impact on tax revenue and expenditure. The Intergenerational Report, released on 5 March, showed that in 2054-55 life expectancy at birth is projected to be 95.1 years for men and 96.6 years for women, compared with 91.5 and 93.6 years today. It also showed that the number of people aged between 15 and 64 for every person aged 65 and over having fallen from 7.3 people in 1974-75 to an estimated 4.5 people today. By 2054-55, this is projected to nearly halve again to 2.7 people. It is important, against this backdrop, that the preservation age be re-considered.

At present, the gap between the Age Pension eligibility age and the preservation age gives rise to a risk that people will deplete their superannuation savings and then fall back on the Age Pension. This reduces the positive impact of superannuation on an individual's quality of life in retirement and reduces the savings to the government.

Given the increase in the Age Pension age to age 67, and then possibly 70, consideration should be given to whether the superannuation preservation age needs to increase.

When the preservation age initially was set at 55, Age Pension age was 60 for women and 65 for men. Since then, the Age Pension age for women has gradually increased to be equivalent to that of men, with the age for both increasing gradually to age 67 by 1 July 2023. It has since been announced that the government intends to increase the Age Pension age to 70 between 1 July 2025 and 1 July 2035. Meanwhile, the superannuation preservation age is increasing from age 55 to age 60 with effect between 2015 and 2024.

Ideally, the preservation age should be linked to the Age Pension age and should be set to be a specified period less than the Age Pension age. If this were done then the preservation age would increase automatically, and in synchronisation with, the Age Pension eligibility age.

If a period of five years were adopted this would see the preservation age increase, in a phased manner, from age 60 to age 62, as the Age Pension age increases to age 67. This would minimise the risk of the dissipation of superannuation monies prior to Age Pension age.

A higher preservation age has a number of impacts on tax revenue, tax expenditures and government outlays:

- Since individuals are contributing to their superannuation for a longer period and drawing down for a shorter period, the number of people who will run out of superannuation and fall onto the Age Pension will be reduced.
- Superannuation balances remain in the accumulation phase for longer, meaning the 15 per cent earnings tax is paid for longer before balances move to the tax free retirement phase.
- As individuals are employed for longer, they pay income tax on their income as opposed to drawing on a tax free income stream in retirement.
- Higher labour force participation contributes directly to higher levels of economic growth and hence higher tax receipts.

In making such changes, however, consideration needs to be given to those older Australians who, for a range of reasons including restricted abilities due to health issues and a lack of employment opportunities, may find themselves unable to find employment, or sufficient employment. If they are unable to access their superannuation, or the Age Pension, this will lead to an increase in both disability and unemployment benefits. There may, therefore, be a need for there to be some form of early access in order to protect this group, outlined below.

The impact of higher unemployment levels for this age group is to reduce the fiscal benefit to the government of raising the preservation age through the off-setting effect of the payment of increased unemployment benefits and Disability Support Pension. Perceived and real employer concerns with employing older workers need to be addressed to ensure as many people in this age group continue to be employed as possible.

If the preservation age were to increase to above age 60 the conditions of release in the SIS Regulations may need to be reviewed in light of this. In particular, the condition of release with respect to the cessation of employment with an employer who had contributed to the fund on or after age 60 could now occur prior to preservation age being reached.

Recommendation

The superannuation preservation age should be set five years below the Age Pension age, up to a maximum of 62.

Early access

Despite some suggestions to the contrary, there is little evidence that the current provisions with respect to early release – either on compassionate grounds or on the grounds of financial hardship – are resulting in undue leakage from the system. Given that superannuation is intended for retirement, it will be critical to ensure that early access is not extended for such purposes as providing a deposit for a house, which not only reduces the amount a person has in superannuation but serves to add inflationary pressure to house prices.

There is evidence that up to 40 per cent of retirements are not voluntary but occur earlier than planned, generally as a function of ill-health or involuntary redundancy.

If there were to be a phased increase in preservation age from 60 to 62, consideration may need to be given to amending the conditions of release to allow at least some access to superannuation for those in this age group who have been unemployed for a prescribed period, say 12 weeks.

This could take the form of access to a limited income stream, similar to the transition-to-retirement pension currently available once preservation age is reached.

This could mean that a person aged 60 to 62 could receive a portion of their benefit as a regulated, non-commutable, income stream. Limitations could be imposed, as they are currently with respect to a transition-to-retirement pension, such that, for example, a maximum of 10 per cent of the account balance could be paid as an income stream per annum.

An exception to the general preservation age could be created when an individual has been employed for 20 or more years in specified occupations involving manual labour where employment at older ages generally would be problematic. Such an exception has a number of overseas precedents and would deal with the difficult cases where individuals could not reasonably be expected to continue with their usual occupation and retraining opportunities are limited.

Another exception might be where an individual has purchased an annuity or other like income stream which provides an annual income at least equal to that required to fund the comfortable ASFA Retirement Standard. Such individuals will receive little or no Age Pension and the public policy grounds for restricting access to superannuation are not strong

Recommendation

Access to a limited income stream should be available from age 60 for:

- those who have been unemployed for a specific period of time
- those seeking to retrain
- Indigenous Australians
- those employed for 20 years or more in specified professions.

Older Australians and workforce participation

Demography change will see participation rates among those aged 65 and over increase strongly, from 12.9 per cent in 2014-15 to 17.3 per cent in 2054-55 and Australians in their late 50s or early 60s are already looking to change the nature of their employment. It is important that the tax system enables greater flexibility in labour force participation.

In this context, the underlying objective of the transition to retirement pension arrangements is to enable older Australians with the flexibility to reduce their hours and responsibility in the workplace and use a superannuation account-based pension to supplement their reduced employment income.

Consideration could also be given to encouraging individuals to stay in the labour force past Age Pension eligibility age by offering an Age Pension bonus to those who continue in paid employment and do not claim the Age Pension at eligibility age. Pension bonus arrangements are relatively common overseas and Australia could use them as a model for a scheme to replace the former, now closed to new entrants, arrangement in Australia.

It is important that the focus of transition to retirement arrangements be on providing the necessary support for those who are both above preservation age to make the necessary changes to their employment arrangements and, along with other complementary polices, support older Australians participating in the labour force more generally.

We welcome this conversation continuing throughout the tax discussion paper process.

Section 3: Superannuation and its interactions with other aspects of the tax system

The inclusion of all aspects of the Australian tax system is a welcome and important aspect of the tax white paper process. The inclusion of all savings vehicles in the tax discussion paper, that is bank deposits, capital gains and dividend imputation, allows for the widest possible review of the tax system with respect to investments. Given the impact that changes to the relative tax treatment of one savings vehicle will have on others in the economy, examination of these issues in the tax white paper process needs also to consider how such changes interact with superannuation.

Changes in the taxation of other savings vehicles

The tax discussion paper also looks at other savings vehicles such as owner-occupied housing, bank accounts and negative gearing. A change to superannuation should not be considered in isolation and needs to be examined in the context of the whole system. For example, while a change to improve equity in the system for those on balances over $2.5 million is desirable, the bulk of the wealth of high net worth individuals is in the form of shareholdings or property, both residential investment properties and commercial real estate. Around $360 billion in total is held in superannuation by those with more than $1 million in superannuation.

This is just over 20 per cent of the $1.6 trillion in investable assets held by high net worth individuals.

For most high net worth individuals, tax arrangements relating to capital gains, negative gearing and the family home are likely to have more impact on the achievement and maintenance of wealth than superannuation tax concessions. Therefore, any change in superannuation should also consider whether other changes to the tax system are needed.

Changes in the taxation of capital gains tax and dividend imputation

The treatment of capital gains tax in superannuation ensures that, when assets are realised within the superannuation fund, a concessional rate of tax is paid. Any proposed change to capital gains tax needs to consider how it would impact on the investment strategies of superannuation funds as well as on returns for members. In addition, any proposed change in dividend imputation needs to consider the impact on superannuation.

In addition, dividend imputation is a feature of the Australian tax system that manages the problem of double taxation of company profits.

While few countries use dividend imputation most countries do have some structure to manage the issue of double taxation. Dividend imputation with refundable franking credits results in an improvement in returns on domestic equity of around 1.3 per cent per annum for accumulation members and 1.5 per cent per annum for pension members.

Over a 35-year accumulation period this translates to an improvement in the accumulation phase of around 8 per cent and in the retirement phase around 13 per cent. If dividend imputation were to be removed this would mean that a full time worker contributing 9.5 per cent over their working life would see a 13 per cent reduction to their income in retirement (around $4,000 per year on average).

The primary impact of removing dividend imputation would be to increase the tax on superannuation fund members, including low to middle income earners. All Australians receiving dividend income would effectively pay at least 30 per cent tax on that income, regardless of the tax rate on their other income.

Dividend imputation credits make it easier for small and medium domestic companies to obtain finance and may result in fewer incentives for corporate tax avoidance. Appendix 5 provides greater detail on dividend imputation and its impact on retirement savings.

Key finding

Removal of dividend imputation would have a negative impact on superannuation, reducing incomes in retirement by $4,000 on average.

Stamp duty on life insurance

The current regime of inefficient state taxes on life insurance provided through superannuation funds has a negative impact on superannuation as a product for the community.

Insurance delivers a valuable benefit to members of superannuation funds, providing cost effective cover in the event of death, total and permanent disability and frequently income replacement during periods of temporary disability. For many members insurance within superannuation is the only life insurance they have in place. In the case of premature death it provides critical support to dependants, while in the event of permanent incapacity and the inability to earn income it can provide a member with financial security.

Australia has a high level of underinsurance and anything that reduces the incentive to take out an appropriate level of life insurance, such as increased costs through stamp duty, contributes to this problem. Without insurance in superannuation the majority of Australians would have no life insurance cover. Underinsurance also has a negative impact on the Federal Budget, as those who have insufficient insurance cover eventually fall onto government welfare payments.

Stamp duties are one of the most inefficient revenue-raising measures. As a tax on transactions, they can act as a disincentive to transactions taking place that would otherwise be beneficial to the parties concerned, as well as to the broader community.

Recommendation

Stamp duty on life insurance should be abolished.

Different life insurance stamp duty treatment across the states and territories

A particular issue relates to the inefficiencies caused by the different stamp duty treatment in each state. One such example relates to the stamp duty levied on life insurance.

Stamp duty applicable to life insurance products is a complex area. The rates and payment of life insurance stamp duty are governed by stamp duty acts in each state and territory, which generally differ from jurisdiction to jurisdiction.

Each Australian state and territory has its own schedule of stamp duty rates payable on life insurance products. As a minimum, consistent treatment between jurisdictions would reduce compliance costs for fund and would benefit members. Ultimately as stamp duty on life insurance can lead to underinsurance, if it were to be abolished this would benefit funds and particularly members (see Appendix 6 for more details).

Section 4: Improving the care and maintenance of the system

The tax discussion paper outlines the importance of a tax system that is equitable, efficient and simple as possible.

ASFA supports these principles along with ensuring that the system is sustainable, delivers adequate incomes in retirement and any change maintains confidence in the system.

As highlighted in the submission, ASFA considers the system is working well. However some consideration of a $2.5 million cap on the level of tax concessions is needed as well as a closer examination of the operation of concessional and non-concessional caps to ensure the system remains equitable. However ASFA also considers that, as the tax consultation process develops, there should be a consideration of 'care and maintenance' issues in the system.

Care and maintenance issues include whether the legislation is consistent, accurately reflects policy and/or whether the underlying policy intent is still applicable in the current environment. ASFA is undertaking further work on identifying some of these 'care and maintenance' issues and we will engage further as the tax process continues.

Recommendation

As the tax discussion process continues, there needs to be further consideration of 'care and maintenance' issues.

Superannuation and the Australian Taxation Office

Using the tax office to facilitate better informed members

The role of the Australian Taxation Office (ATO) in superannuation has evolved over the years, as has the design and implementation of new measures.

Importantly, engagement between Treasury, the ATO and the superannuation industry has resulted in the design of increasingly efficient processes.

Prior to 1996, the ATO played a limited role in superannuation. In essence, the role of the ATO was:

- to collect income tax from superannuation funds
- to track the level of superannuation and employment benefits paid to individuals and impose additional tax where the total of the benefits paid exceeded the individuals' RBL
- to administer the *Superannuation Guarantee (Administration) Act 1992* and the *Superannuation Guarantee (Charge) Act 1992*.

The introduction of the Superannuation Contributions Surcharge (the Surcharge) in 1996 required the ATO to expand the data it collected from superannuation funds. Under the Surcharge, taxable contributions attributable to members whose adjusted incomes exceeded a nominated level were subject to additional taxation. However, the assessment for that tax was levied on the trustee of the fund to which that member belonged.

Central to the ATO's administration of the Surcharge was the collection from funds of information about contributions made with respect to fund members and information about notional contributed amounts with respect to members of defined benefit funds. The data collection process is referred to as Member Contributions Statement (MCS) reporting.

ASFA recommends that the design of administration processes for any proposed initiatives is based, as far as possible, on the ATO accessing MCS data and combining this information with income tax data.

ASFA also recommends that better use is made of the amalgamated superannuation data that is reported annually to the ATO. While the myGov data is an excellent initiative and accessed by many Australians, the vast bulk of superannuation members are not accessing their superannuation data in this way. ASFA believes that providing individual Australians with a summary of their superannuation balances, through a mechanism with which they are known to engage, would be a powerful tool to encourage better engagement.

Recommendation

The ATO should be tasked to consolidate, on an individual taxpayer basis, information from annual MCSs and use that information to prepare an amalgamated superannuation balance statement for inclusion with the notice of assessment of each taxpayer following the lodgement of their annual income tax return.

Reducing non-payment of superannuation contributions

The non-payment of superannuation entitlements by employers is a considerable and preventable problem which is reducing the retirement incomes of many Australians.

Research commissioned last year by Cbus, AustralianSuper and REST found that the non-payment of superannuation by employers affects around 650,000 Australian workers, leaving them collectively out of pocket almost $2.5 billion annually.

Research by Tria Partners found that the average person affected loses around $3,750 per annum in superannuation contributions, which equates to around nine months' worth of superannuation for someone on average weekly earnings.

The loss of superannuation impacts more heavily on younger and lower-income Australians. For a 25 year old, a one-off loss of this magnitude could equate to a loss of $13,500 at retirement in today's dollars. Those in more vulnerable circumstances, industries or employment modes may endure multiple losses throughout their working life. Foreign workers and those for whom English is a second language are particularly susceptible.

The follow up of employee complaints by the ATO is resource intensive. There is also scope for more proactive activity by the ATO in order to identify, at an early stage, employers who are at risk of not making required superannuation payments on behalf of their employees.

Recommendation

Additional funding should be devoted by the ATO to respond to employee complaints about non-payment of superannuation contributions and to improve the level of SG compliance generally.

Enhancing the benefits of SuperStream

In February 2014, the government tasked the ATO with stewardship of the Superannuation Transaction Network (STN) of gateways for a two-year period with self-regulation of the network to start from the second quarter of 2016. The ATO is currently running an expression of interest process for governance of the network from 2016 – Gateway Network Governance Body (GNGB).

ASFA is supportive of a GNGB and the ATO's timetable for transition.

ASFA has assessed a number of funding options reflecting the different level of participation and governance by and of various participants and possible collection methods that deliver on the above principles. These require further discussion and consultation.

ASFA considers some government funding via industry levies an important component of the ongoing financial viability of the GNGB, particularly in the initial period of operation while the consultation occurs with industry participants to develop an appropriate model for self funding. ASFA also believes that the employer component of the funding should be sourced from consolidated revenue as there is no other feasible method of raising the funds from employers.

Recommendation

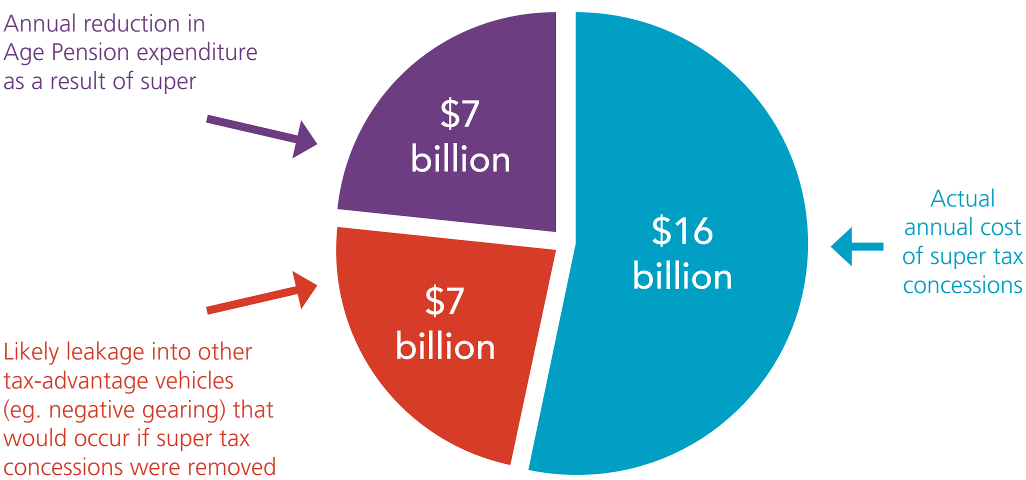
The government should work with the industry to establish a mechanism for funding the GNGB. The employer component of funding should be sourced from consolidated revenue.

Section 5: Superannuation, the budget and the economy

Superannuation has a unique place in the Australian economy and the tax settings in superannuation need to be considered in the context of other taxes and the impact that superannuation has on the budget and the economy as a whole.

Sustainability: the budget cost of tax concessions in superannuation

The Tax Expenditure Statement currently states that the cost to the budget of superannuation tax concessions is around $30 billion per annum. However, when the savings the government makes on the Age Pension as a result of superannuation is taken into account, together with the impact of behavioural change (people shifting money from one tax-effective vehicle to another) that would occur if super tax concessions were removed, a more accurate estimate would be around $16 billion a year. This is shown in the diagram below. ASFA's *Mythbusting superannuation tax concessions* paper is attached at Appendix 7.



Key finding

The cost of superannuation tax concessions to the government is substantially lower than that reported in the Tax Expenditure Statement.

Superannuation reduces the cost of retirement policy

Retirement income adequacy is an important goal of government policy. An efficient policy solution is one that achieves this goal with minimal distortions and low impact on the economy.

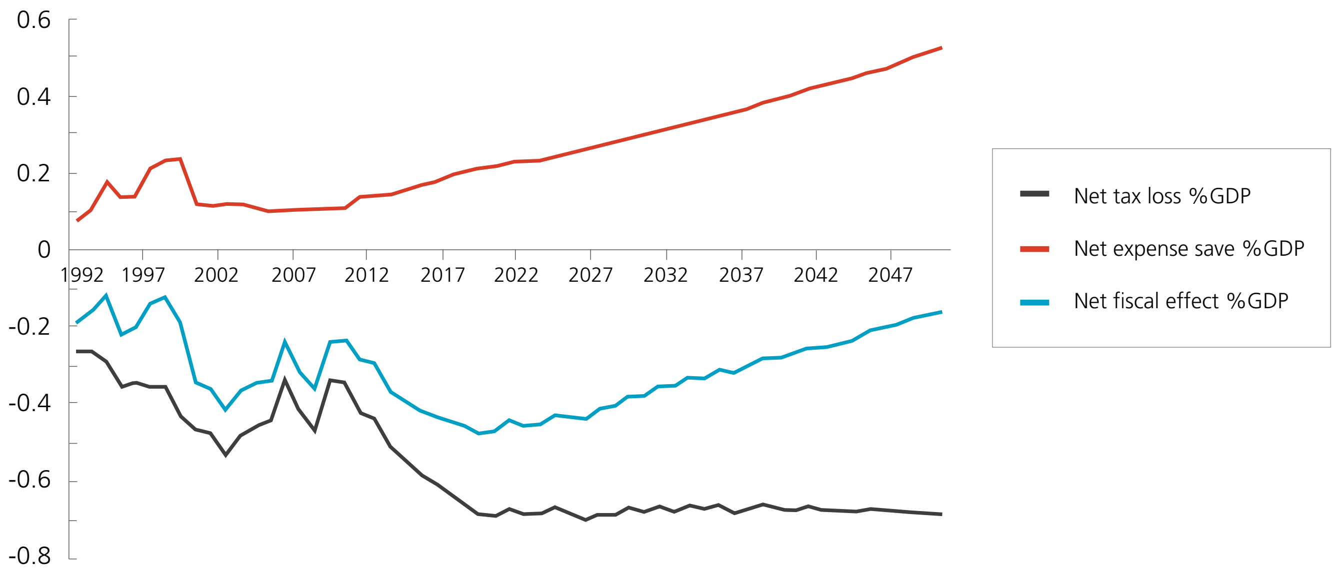
With the current legislated settings for the SG, expenditure on the Age Pension is projected to reach 3.6 per cent of GDP in 2054/55. In the absence of superannuation savings, expenditure on the Age Pension would be likely to reach 5.5 per cent or more of GDP by 2054/55 and retirement incomes on average would be much lower.

Superannuation is a maturing element of the retirement income system. As asset levels grow, the cost of this element of the system in the form of tax expenditures also grows. However, this cost is offset by reduced public pension payments. Treasury modelling in Charter Group (2013) of an increase in SG from 9 to 12 per cent shows the net cost impact of such an increase improving relatively soon after implementation, as the cost of concessions stabilises but the benefit in reduced pension outlays continues to improve. The trend is towards a positive overall impact of an increase in the SG as the system matures, despite population ageing (see Figure 3).

Key finding

Tax concessions in superannuation, by encouraging voluntary contributions to superannuation, are reducing the cost of the Age Pension.

Figure 3: Projected net cost: SG increase and public pension

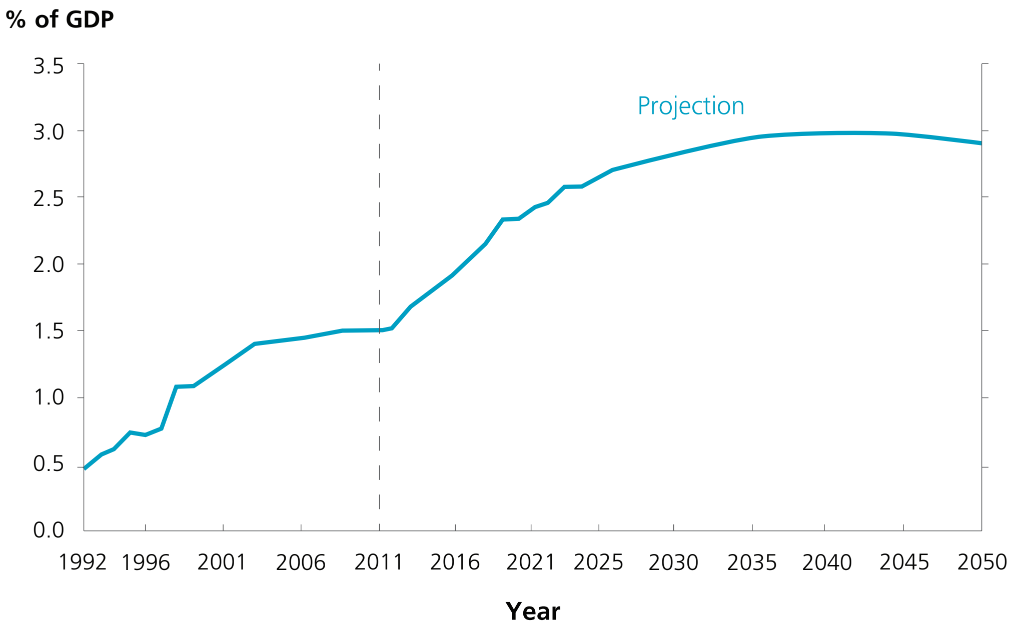


Source: Treasury modelling, in Charter Group (2013).

Superannuation improves the national saving rate

Compared to other OECD countries, and particularly countries with similar financial systems, Australia has an above average saving rate. Superannuation makes a major contribution to the relatively high saving rate. Gruen and Soding (2011) from the Australian Treasury estimate that the superannuation system currently contributes about 1.5 to 2 percentage points to the national saving rate, rising to 3 percentage points by 2050 (Figure 4).

Figure 4: Contribution of superannuation to national saving



Source: Gruen and Soding (2011).

An important question is the extent to which saving due to compulsory superannuation and tax concessions is offset by reductions in other forms of saving.

The Treasury estimates in Figure 4 assume an offset of other savings of about 50 per cent, while a 30 per cent offset is a more common estimate (Kirchner, 2012). These estimates also assume that the tax concessions offered to superannuation do not displace other forms of government saving (Gruen and Soding, 2011).

However, other Australian research indicates offsetting is limited or non-existent[2]. An important explanation could be that in the absence of rational decision making about how much one ought to be saving, the compulsory rate acts as a suggestion to consumers, influencing their ideas of how much they ought to be saving.

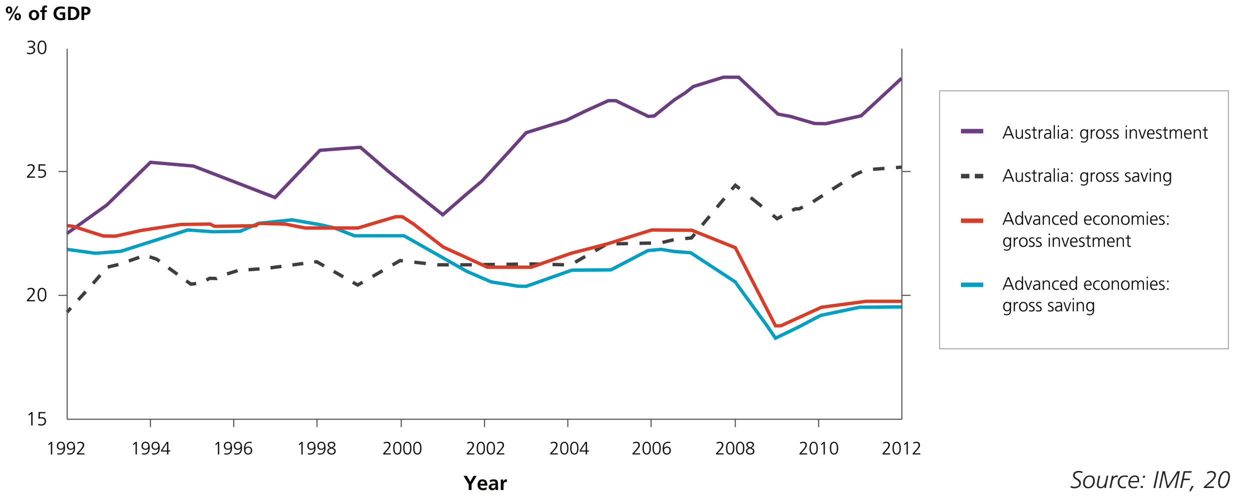
Given the recent research on offsetting behaviour, the Treasury estimates of how much superannuation contributes to national saving are likely to be a conservative estimate.

[2] Work by Connolly (2007) finds that an additional dollar of compulsory super adds between 70 and 90 cents to total household savings. Shanker and Vidler (2014) find no statistically significant offsetting behavior between workplace default contributions and voluntary contributions.

Superannuation reduces reliance on foreign capital

While Australia has a higher saving rate relative to some comparable economies, Australia has traditionally been a net importer of capital because domestic saving has not met the high demand for investment in Australia (Figure 5).

Figure 5: Australian saving and investment rates



Source: IMF, 2014.

Using foreign funds for domestic investment has been a feature of the Australian economy, and is not necessarily inefficient, because Australia's current account deficit is driven by high investment demand (Mercerau and Rozhokov, 2006). However, relying on foreign sources of finance does expose Australian firms to global economic shocks. This could be particularly the case since Australia's foreign liabilities are mostly in the form of debt, in 2014 only $0.9 trillion out of $2.5 trillion of total liabilities were in the form of equity[3]. Debt liabilities, particularly short-term debt, presents a rollover risk, where due to foreign shocks, foreign lenders may be unwilling or unable to re-finance loans.

An important factor, along with the general health of Australia's financial system, in mitigating the risk of foreign liabilities is having sources of capital available from Australian superannuation. Not only does this domestic source of capital reduce the vulnerability of firms to foreign shocks, but it reduces the risk premium foreign investor's demand when investing or lending to Australian firms (FSC, 2014). Easier access to domestic capital for local investment projects can thus also increase investment, and result in greater long-term output and growth.

During the GFC, when capital was most urgently needed to support continuing economic activity the availability of capital to Australia was reduced. The Australian currency fell, reflecting perceptions of Australia as a relatively high risk investment destination, and risk premiums in global capital markets increased. Overseas capital markets effectively froze. Australian corporations, including the major banks, seeking to recapitalise their balance sheets, turned to Australian superannuation funds to supply equity capital via placements and other raisings. Secondary capital raisings on the ASX during 2007, 2008 and 2009 were $62b, $60b and $99b respectively (ASX, 2010), with subscriptions dominated by institutional investors, particularly domestic superannuation funds (SMH, 19/12/2009).

Commentators have already predicted that Australia's superannuation savings will result in a reversal of the current account deficit, with Australia becoming a net lender (Michael Blythe, 2014). Recent data suggesting a narrowing of the Australian current account deficit is consistent with this prediction (ABS, Cat No. 5302).

This potential reversal or at least dampening of the current account deficit must be viewed from the perspective of savings efficiency. Australian consumers may still be saving too little from the point of view of inter-temporal efficiency. The resulting growth from greater domestic investment can thus be seen as welfare improving[4].

Key finding

Superannuation has contributed to a higher level of savings than would otherwise be the case which:

- has reduced the cost of capital in Australia and had a positive impact on economic growth; and
- assisted Australian companies to refinance during the recent financial crisis when international capital was scarce.

---

[3] Australian Bureau of Statistics (ABS) 2014, *Balance of Payments and International Investment Position*, cat. no. 5302.0, ABS, Canberra.
[4] A higher level of saving and investment is not always efficient. This is because saving today comes at the cost of consumption today. The efficient balance is given by the inter-temporal optimisation of consumers; but if consumers are not making optimal saving decisions, higher saving improves welfare.

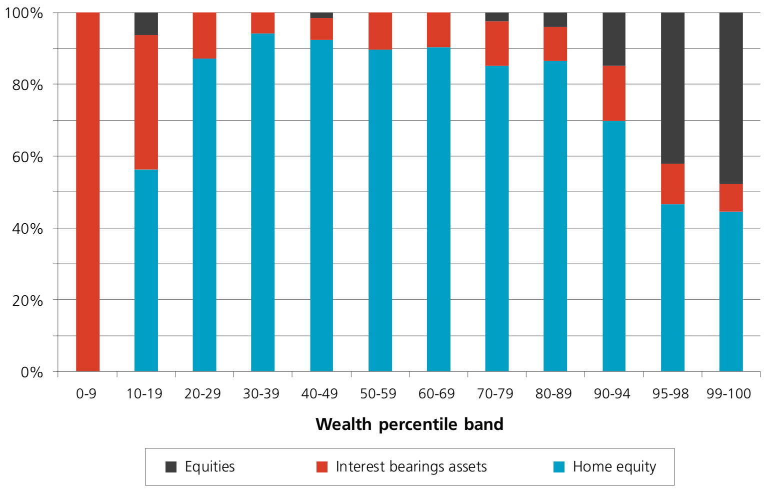
Household balance sheet diversification

An important advantage of the superannuation system is that it has facilitated a broadening of the range of assets held by households.

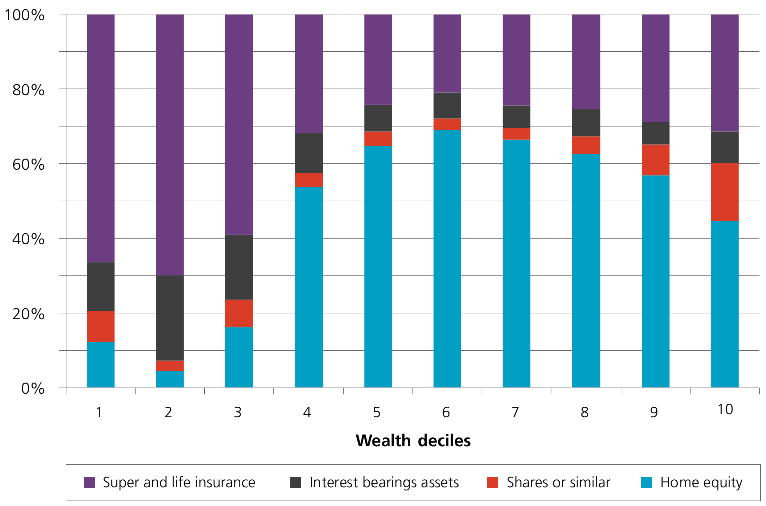
In 1990, most households kept the majority of wealth in real estate, particularly the family home, with 10 per cent of wealth also held in bank accounts. Only the top 10 per cent of households by wealth had any significant holdings of financial assets, such as shares in listed companies (Figure 6).

However, by 2010, the range of assets held by households across the income distribution had broadened, particularly through superannuation. This reduces the relative exposure of households to the Australian residential property market, giving many households exposure to equity and bond markets for the first time as well as infrastructure and commercial property, and geographic diversification through exposure to overseas assets. Given the concentration of the Australian economy and listed equity market in the financial and mining industries, international exposure also gives a significantly broader industrial diversification.

Figure 6: Household asset composition, by wealth band, 1990 and 2010



Source: Bacon (1995).



Source: ABS (2012).

Figure 6 shows the effect of superannuation on the composition of household assets. Two decades later, in 2010, households all the way across the wealth distribution hold financial assets (Figure 7), predominantly in the form superannuation.

Universal superannuation has unambiguously improved the asset diversification of Australian households. For the first time, many families outside the wealthiest 10 per cent have a broad asset base outside the family home. Exposure to equities, bonds and commercial property is now shared more evenly across the wealth distribution. Asset classes such as infrastructure equity and debt are available to all workers through MySuper products. APRA-regulated superannuation funds have also contributed to a reduction in 'home bias' by investing a significant minority of assets overseas.

These factors contribute to improved risk adjusted returns and reduce exposure to the housing market, particularly for low to middle income workers.

Key finding

Superannuation has contributed to broader and more risk appropriate investment by individuals and the professional investment of savings through superannuation has had a positive impact on economic growth.

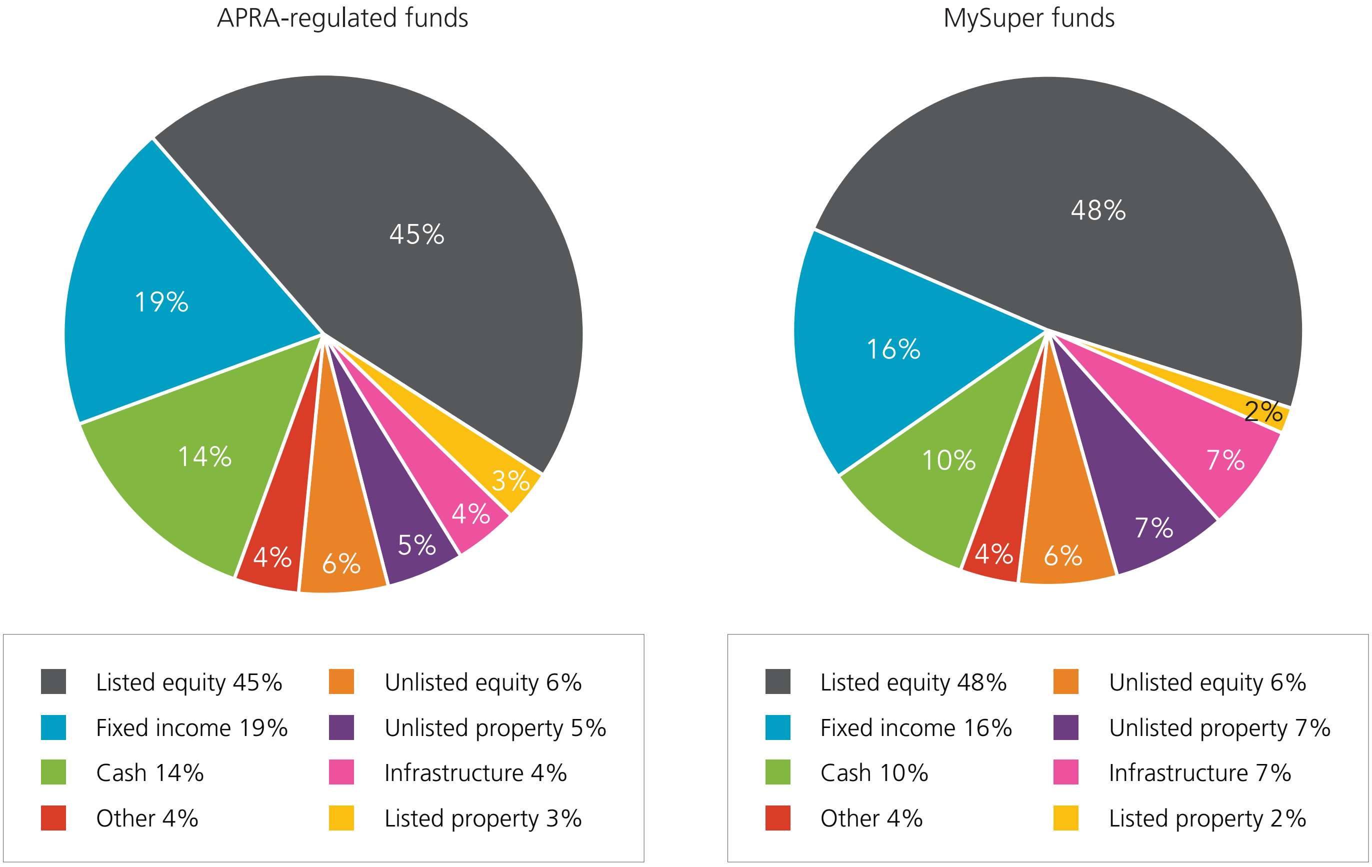
Patient capital for alternate asset classes

The investments made by professional investment managers in APRA-regulated superannuation funds are diverse and include support for critical parts of the economy that may not be available through other means, including infrastructure, private equity, and commercial and industrial property.

Pooled superannuation allows investment in lumpy assets and over longer time horizons than is the case for most individual investors. Figure 7 shows the asset allocation of APRA-regulated superannuation funds.

Approximately 19 per cent of all APRA-regulated fund assets, or $232 billion is invested in unlisted equity, unlisted property, infrastructure or other alternative assets. In workplace default MySuper products these categories represent 24 per cent of investment, or approximately $94 billion.

Figure 7: Large APRA fund and MySuper products, asset allocation, 2014



Source: APRA 2015.

Infrastructure drives productivity improvement and growth. A shortfall in infrastructure investment in Australia is hampering economic growth, notably in transport and telecommunications. Established infrastructure assets are particularly well-suited to pension fund investment because they generate income over the long term, tend to have defensible, regulated market positions and have counter-cyclical properties.

Superannuation funds have also contributed significantly to private equity investment, including venture capital. Superannuation funds are the largest investors in private equity in Australia, having now committed over $8.5 billion out of a total commitment of $18.5b (ABS, Cat No. 5678.0, 2015).

Key finding

The tax treatment of superannuation, by encouraging voluntary contributions, has contributed to the creation of pool of capital which is available for long-run investment such as infrastructure and start-ups that would not otherwise exist. This has had a positive impact on economic growth.

Appendix 1

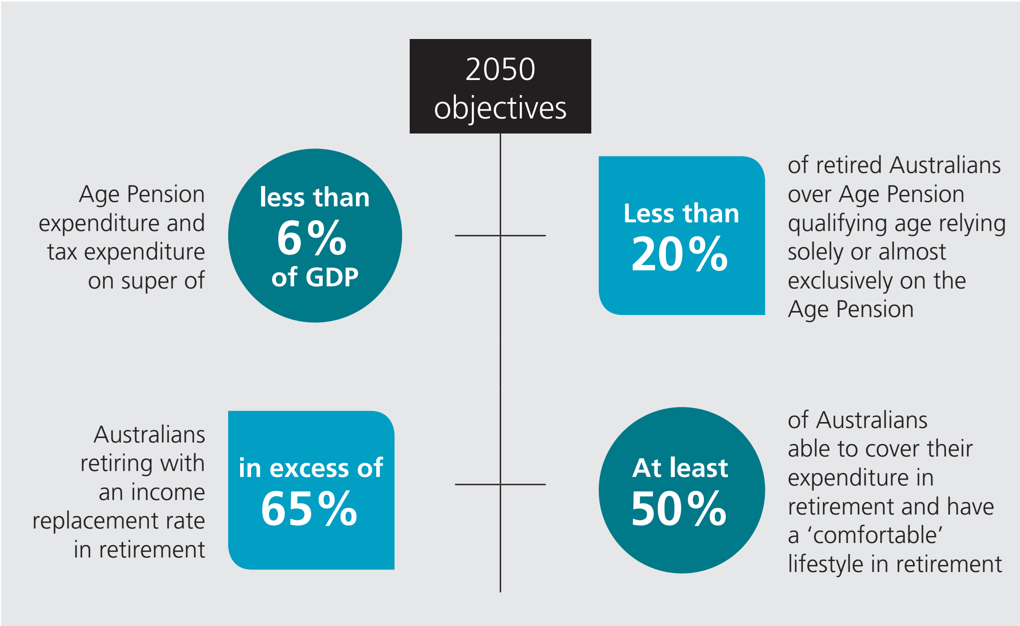
Measuring the performance of the superannuation and retirement system

ASFA has proposed four quantitative objectives for the superannuation and retirement system in order to guide the design of superannuation and retirement income policy settings. These objectives focused on the cost of the Age Pension and tax concessions for superannuation relative to GDP, levels of reliance on the Age Pension, the level of income replacement in retirement and the percentage of the retired population living at a standard equivalent at least to the ASFA Retirement Standard 'comfortable' level.

ASFA's paper, *The future of Australia's super: a new framework for a better system*, identified some specific goals for superannuation against which success can be measured. Specifically, the goals of superannuation by 2050 could be:

- Age Pension expenditure and tax expenditure on super (properly measured) of less than six per cent of GDP
- less than 20 per cent of retired Australians over Age Pension qualifying age relying solely or almost exclusively on the Age Pension
- Australians retiring with an income replacement rate in retirement – in terms of household disposable income – in excess of 65 per cent of final income (on average)
- at least 50 per cent of Australians able to cover their expenditure in retirement and at least have a 'comfortable' lifestyle in retirement, as described in the ASFA Retirement Standard.

Objectives of the superannuation system, 2050



ASFA's paper, *The future of Australia's super: a new framework for a better system*, also outlined the need for principles that would underpin the objectives of the system. These principles would be used to help frame policy on retirement income and tax policy settings.

Appendix 2

Measures of adequacy

While superannuation may be achieving its primary objective at the highest level by substituting and supplementing the Age Pension, it is the degree to which the system is achieving this that is important. This appendix provides more detail on measurement of adequacy of the current system.

One of the most important steps in establishing what is an adequate retirement income is calculating how much is needed to be spent each year in retirement to support a comfortable lifestyle. However, many people struggle when it comes to developing a budget for their future needs, particularly when their retirement is many years away.

The ASFA Retirement Standard has been developed to help solve this problem by objectively outlining the annual budgets appropriate for various categories of Australians to fund their needs in their post-work years. It provides benchmarks for both a comfortable and modest standard of living, for both singles and couples, and is updated quarterly to reflect changes to the consumer price index (CPI). Modest and comfortable standards of living in retirement are relevant to the bulk of retirees.

First launched in 2004, the Standard has been enhanced over the past 10 years to increasingly provide a more comprehensive picture of retirees' spending requirements. It has also been revised to reflect changes in living standards, retirees' lifestyle expectations and their evolving spending patterns.

In 2015, ASFA launched a new Retirement Standard for older retirees, designed to provide a picture of how spending requirements change as people enter their late 80s and early 90s. Like the original Standard, it provides benchmarks for both a comfortable and modest standard of living, for both singles and couples, and is updated quarterly to reflect changes to the CPI.

What is considered a modest and comfortable retirement lifestyle for retirees?

A modest retirement lifestyle is considered better than the Age Pension, but still only enables retirees to afford fairly basic activities.

A comfortable retirement lifestyle enables an older, healthy retiree to be involved in a broad range of leisure and recreational activities and to have a good standard of living through the purchase of such things as: household goods, private health insurance, a reasonable car, good clothes, a range of electronic equipment, and domestic and occasionally international holiday travel. For those aged 85 and over it is assumed that a car is not owned and there is no international holiday travel, but medical and aged care expenses are higher.

The various budget levels assume that the retirees own their own home outright.

Table 1: Budgets for various households and living standards for those aged around 65 (March quarter 2015, national)

	Modest lifestyle		Comfortable lifestyle	
	Single	Couple	Single	Couple
Housing - ongoing only	$70.05	$67.25	$81.19	$94.12
Energy	$41.87	$55.61	$42.49	$57.63
Food	$77.27	$160.07	$110.39	$198.71
Clothing	$17.45	$28.33	$37.78	$56.67
Household goods and services	$26.57	$36.03	$74.75	$87.57
Health	$41.31	$79.73	$81.96	$144.65
Transport	$90.76	$93.33	$135.25	$137.82
Leisure	$74.01	$111.76	$227.32	$311.52
Communications	$9.19	$16.09	$25.26	$32.15
Total per week	**$449.50**	**$648.20**	**$816.40**	**$1,120.84**
Total per year	**$23,438**	**$33,799**	**$42,569**	**$58,444**

Table 2: Budgets for various households and living standards for those aged around 85
(March quarter 2015, national)

	Modest lifestyle		Comfortable lifestyle	
	Single	Couple	Single	Couple
Housing - ongoing only	$70.05	$67.25	$81.19	$94.12
Energy	$41.87	$55.61	$42.49	$57.63
Food	$77.27	$160.07	$110.39	$198.71
Clothing	$17.45	$28.34	$37.78	$56.66
Household goods and services	$46.65	$66.14	$145.03	$167.87
Health	$89.23	$138.52	$122.20	$194.94
Transport	$37.76	$47.20	$42.48	$51.92
Leisure	$47.79	$71.30	$123.53	$170.76
Communications	$9.14	$16.00	$25.11	$31.96
Total per week	**$437.22**	**$650.42**	**$730.20**	**$1,024.57**
Total per year	**$22,798**	**$33,915**	**$38,075**	**$53,424**

The figures in each case assume that the retiree/s own their own home and relate to expenditure by the household. This can be greater than household income after income tax where there is a drawdown on capital over the period of retirement. Single calculations are based on female figures. All calculations are weekly, unless otherwise stated.

From age 65 up until age 90, the gap between the full Age Pension and the spending required to live a comfortable retirement is around $25,000 a year for a couple and around $20,000 a year for a single person. Currently this would require a retirement savings balances at age 65 for a couple of $510,000 and $430,000 for a single to achieve this over a period until they are about 90.

Taking the expenditure needed to sustain a comfortable lifestyle while a single or couple are in their 90s changes these numbers. More years of expenditure have to be funded, albeit at a lower level due to the changes in expenditure required. A single person living into their 90s would require $10,000 per year in addition to the Age Pension to fund a comfortable lifestyle, while for a couple the figure is around $20,000. Budgeting for this additional 10 years, requires around $45,000 in additional private retirement savings at age 65 to accommodate these additional years of expenditure after age 90. A couple would need to save around $50,000 more by age 65.

At age 80, a couple would need to still have about $360,000 in retirement savings to be confident that they could have a comfortable standard of living well into their 90s, while for a single person the figure is around $260,000.

At age 90, the figures are much lower, reflecting the reduced life expectancy at that age. A couple would need about $120,000 in remaining retirement savings while for a single person the figure is $70,000.

The amount of retirement savings needed at Age Pension qualifying age will change with the proposed tightening of the asset test for the Age Pension. The tightening of the asset test will not impact on the savings required to support a modest lifestyle in retirement or on the savings needed to be in place at age 85 to support a comfortable standard of living in retirement, but it will impact on the savings needed for a comfortable standard of living from age 65.

Increasing the taper rate for part-pensioners from $1.50 to $3.00 per $1,000 of assets, while also increasing the threshold at which the asset test starts to apply, would require a couple to save around $120,000 more for a comfortable retirement, requiring a super balance of $630,000.

There will be a greater impact on single retirees, who will need to save $180,000 more in superannuation or a total balance of $610,000. Both figures assume the retirees will draw down entirely on their capital, and receive as part-pension as their assets decrease.

Retirement income adequacy for higher income earners

For those on well above average incomes during their working years, the ASFA Retirement Standard budgets may have only some relevance. Often those on relatively high incomes look to a percentage replacement rate of income in retirement. Rule of thumb guides that are applied in financial planning contexts are usually around 60 per cent of gross pre-retirement income or 70 per cent to 75 per cent of net, after tax, pre-retirement income. A separate question, addressed in Section 2 of this submission, is what level of retirement savings and retirement incomes should receive concessional tax treatment.

Appendix 3

Income stream tax option

ASFA's primary recommendation for reforms that reduce tax concessions for those with very large balances (above $2.5 million) is to cap the amount that can be carried into the retirement phase (see Section 2). However, another option could be to tax incomes of those with very high balances. This appendix outlines the details of this option.

Once an individual's income stream payments from superannuation in a year exceeds twice the ASFA comfortable retirement level ($125,000), a flat rate of tax of 15 per cent would be applied to that part of the income stream payments that exceeded $125,000. Ad hoc, lump sum withdrawals from the income stream would count toward the $125,000 threshold, and only those with balances of over $2.5 million would be taxed.

Design/mechanics

Individuals would need to be receiving combined income streams and lump sums of over $125,000 and have total superannuation monies over $2.5 million to trigger the tax. This would ensure that the ability of individuals with lower balances to drawdown lump sums is not affected.

The minimum drawdown requirement from an income stream for those aged 65 to 74 is 5 per cent. At this rate, a balance of $2.5 million leads to a minimum drawdown of $125,000.

Individuals would be required to lodge a tax return. A flat rate of tax rather than marginal rates of tax has been applied so as to overcome two potential problems:

- If the marginal rate applies for incomes above $125,000 only, then the tax-free threshold would apply and few individuals would pay the tax.
- If the marginal rate was applied to the full income, individuals would face an unacceptably high effective marginal tax rate.

Those who keep their balance in the accumulation phase would not be advantaged, as their superannuation monies would remain subject to the existing 15 per cent earnings tax that applies in the accumulation phase.

Implementation challenges

- Personal income tax returns will need to be amended to capture all payments from superannuation income streams (income stream payments and ad hoc lump sum withdrawals), and this may require additional, or more timely, reporting by funds to members. The alternative is that funds report all income stream information to the ATO, which then issues an assessment to the individual.
- Appropriate allowance would need to be made for return of capital or other relevant deductible amount, while at the same time not compromising the integrity of the measure.
- Appropriate treatment of reversionary income streams (payable on death of the primary recipient) may be problematic.
- Further consideration would need to be given to how defined benefit schemes would be treated.

Appendix 4

Policy options to address broken work patterns

As outlined in Section 2, it is ASFA's view that there is a need to make the concessional contributions caps more flexible or higher to accommodate people with broken working patterns, fluctuating incomes or variable expenses being able to "catch-up" in the making of concessional contributions.

As an accompanying integrity measure, this could be accompanied by the introduction of a lifetime concessional contributions cap.

Options

1. Permanent, higher, annual concessional contributions cap of $45,000 (indexed)

Confining the concessional contributions cap to $30,000 serves to limit the extent to which people who are returning to the workforce, or whose disposable income begins to increase, or whose expenses begin to decrease (for example as mortgage payments begin to represent a smaller proportion of income) are able to make "catch-up" concessional contributions.

It is important to note in this context that the annual non-concessional contributions cap for the 2014-15 year is $180,000, which can be "brought forward" on a rolling three-year basis to enable a member to contribute an amount up to $540,000. While non-concessional contributions are made from "after tax" income, and so the making of the contribution does not represent a cost to revenue, given that earnings are taxed at (nominal) 15 per cent (effective approximately 13 per cent) as opposed to marginal tax rate, this nevertheless represents a material cost to revenue.

The concessional contributions cap could be increased to bring it more into line with the non-concessional contributions cap.

This option has the advantage of being straightforward, readily understood by members and easy for funds to implement.

2. Lifetime concessional contributions cap of $1 million (indexed)

If the concessional contributions cap is increased to $45,000 (indexed) to accommodate people being able to "catch-up" in the making of concessional contributions, then this could be accompanied by an integrity measure in the form of a lifetime concessional contributions cap. The amount of concessional contributions which an individual would be able to receive over their lifetime would be capped at $1 million.

Once the cap was reached a member would be able to elect not to receive further concessional contributions (similar to the mechanism which was in place pre-2007 for when members reached their RBL), or could decide to be subject to the excess tax. If a member did not make this election, concessional contributions could continue to be made and the member would be subject the excess concessional contribution tax or could elect to have the excess contributions refunded.

The level of $1 million has been set as a reasonable but not excessive amount to receive the benefit of concessional tax treatment. Few people would have the earning capacity to reach the concessional contributions lifetime cap – it would necessitate over 33 years of full-time employment, with contributions being made at the level of the current concessional contributions cap ($30,000) every year, to equate to $1 million (indexed).

Implementation challenge

Consideration would need to be given as to how to deal with those members who reach their lifetime concessional contributions cap. As per above, this is likely to apply to relatively few people. Either the member could elect not to receive further concessional contributions or they could continue to be made, with the member incurring the concessional contributions tax or applying for a refund of the excess contributions.

Appendix 5

Dividend imputation

As outlined in Section 3, the removal of dividend imputation would have a significant impact on retirement incomes. This Appendix provides greater detail on dividend imputation and its role in retirement incomes.

An incorporated company is owned by shareholders, who provide the company with equity capital. Companies generally pay dividends to shareholders from after-tax profits. These dividends represent an important part of the return on equity investment. When shareholders receive dividends, these may be treated as taxable income. If the return to equity is taxed as both company and personal income, it is taxed at a much higher level than other income.

Few countries use dividend imputation, but most countries do have some structure to manage the issue of double taxation, including rebates or concessional taxation of dividend income. A number of countries do not treat dividend income as taxable personal income.

Dividend imputation with refundable credits is particularly valuable to superannuation fund members because the tax rates for super funds (15 per cent for accumulation members and 0 per cent for pension members over 60 years of age) are lower than the corporate tax rate (30 per cent). A franked dividend of $100 is grossed up to $143 ($143 x 30 per cent = $43) resulting in after-tax returns of $122 for an accumulation fund member and $143 for a pension fund member.

Dividend income makes an important contribution to total return for domestic listed equity. The 10-year total return on the S&P ASX 200 Index to January 31 2015 was 7.7 per cent, consisting of 3.1 per cent capital gain and 4.6 per cent dividend income.

Using these numbers as the basis for calculation, and assuming 75 per cent of dividends are franked, the 4.6 per cent dividend income is grossed up 1.5 per cent to 6.1 per cent. When taxed at 15 per cent this leaves an after-tax profit (on dividends alone) of 5.2 per cent for accumulation members. This will result in a total after-tax return on domestic equity of 8.0 per cent for accumulation members and 9.2 per cent for pension members. This compares to after-tax returns (without dividend imputation) of 6.7 per cent for accumulation members and 7.7 per cent for pension members. Dividend imputation adds an estimated 1.3 per cent to accumulation member domestic equity returns and 1.5 per cent for pension members.

Assuming an allocation of 30 per cent to domestic equities, dividend imputation adds approximately 0.4 per cent or 40 basis points (bps) per annum to accumulation fund returns overall and 0.45 per cent or 45 bps per annum to pension fund returns. Over a 35 year accumulation period, this translates to an improvement in accumulation of around 8 per cent. The higher return in retirement phase is consistent with an additional improvement in retirement income of around 5 per cent, giving an estimated overall benefit of 13 per cent.

A full-time worker on average wages reliant on compulsory SG contributions introduced in 1992 would currently have an accumulation of around $155,000. If that member was at retirement age, that sum could be expected to generate a wage-indexed income of around $30,500, including nearly a full public pension and around $8,800 from a superannuation account-based pension. A reduction of 13 per cent in superannuation pension income would cost this member around $1,150 per annum, indexed to wages.

After a full working life at 9.5 per cent employer contributions, a fulltime worker on average wages could expect to accumulate around $540,000 in today's dollars, providing an income of around $40,000, including a part public pension and around $31,000 from a superannuation pension. A reduction in income of 13 per cent would cost this member around $4,000 per annum in superannuation pension income, indexed to wages.

Notably, under current Age Pension means testing rules, around half of this cost would be borne by the taxpayer as the retiree's part-pension entitlement would increase.

Not all of the benefit in future after-tax yield is priced into current share values as franking credits are not available to foreign investors, who hold 40-45 per cent of shares in the Australian market and are therefore influential in setting marginal prices.

Making franking credits non-refundable would largely remove the benefit of dividend imputation to taxpayers on 0 and 15 per cent tax rates including low to average income earners and superannuation fund members. The impact would be particularly significant for pension fund members who have no earnings tax liability against which to use an offset. The after-tax return from dividends, which have been the main source of return from domestic equities over the last decade, would be reduced by 18 per cent for accumulation fund members and 30 per cent for pension fund members.

The relative attractiveness of debt and equity investment would shift, and some equity price decline would be expected as the partial inclusion of franking credits in the value of shares is unwound. The price of equity financing for Australian corporations would therefore increase.

ASFA considers that dividend imputation is supported by both tax and economic theory. It also substantially boosts the eventual retirement incomes for most Australians.

A detailed paper by the consultant Vidler Policy and Research, commissioned and published by ASFA, provides further details.

Appendix 6

Stamp duty on life insurance

As outlined in Section 3, ASFA considers that there may significant economic gains associated with state tax reform. In particular, stamp duties are one of the most inefficient revenue-raising measures. As a tax on transactions, they can act as a disincentive against transactions taking place that would otherwise be beneficial to the parties concerned, as well as to the broader community. This appendix provides greater detail on the impact of different life insurance stamp duty rates on superannuation funds and fund members.

Different life insurance stamp duty treatment across the states and territories

A particular issue relates to the inefficiencies caused by the different stamp duty treatment in each state. One such example relates to stamp duty levied on life insurance.

Stamp duty applicable to life insurance products is a complex area. The payment and rates of life insurance stamp duty are governed by duties or stamp duty acts in each state and territory, which generally differs from jurisdiction to jurisdiction.

Each Australian state and territory has its own schedule of stamp duty rates payable on life insurance products. The table below summarises the stamp duty payable on certain insurance products as at 1 July 2014.

Type	NSW	ACT	VIC	QLD	WA	SA	NT	TAS
Accident – standalone	5%*	2%*	10%	9%	10%	11%	10%	10%
Temporary or Term Life	5%*	2%*	0%	5%*	0%	1.5%	5%*	5%*, 2% mortgage
Life insurance rider (TPD, trauma & disability premium wavers)	5%*	2%*	10%	5%*	10%	11%	5%*	5%*
Life insurance rider (accidental death)	5%*	2%*	10%	5%	10%	11%	5%*	10%
Trauma – standalone	5%	2%*	10%	9%	10%	11%	10%	10%
Disability income	5%	4%	10%	9%	10%	11%	10%	10%

*Stamp duty payable on first year's premiums only.
Source: CommInsure.

Apart from minor exceptions, the obligation to pay stamp duty rests with the life insurance provider. However, the cost of stamp duty may be passed on to the end customer (i.e. in the case of superannuation, passed on to superannuation fund members).

The jurisdiction of applicable stamp duty is governed by the residence of the life insured (i.e. the superannuation fund member), not the policy owner (i.e. not the superannuation fund).

ASFA contends that the different stamp duty rates impose unnecessary administrative costs for superannuation funds as they have to track member movements between states to ensure that the correct amount of stamp duty is applied. Often funds are not notified for 12 months or more after a person has moved. Therefore, the requirement to track movements between states is particularly burdensome for superannuation funds.

As well, stamp duty changes over recent years have meant that in various states grandfathered stamp duty rates apply to certain policies. This means policyholders in the same state or territory may have different stamp duty rates applied on their policies based on their policy inception date. This includes the changes in Queensland on 1 August 2013 and Western Australia in 2004 and 2007.

Specific issue – recent changes to stamp duty on life insurance in Victoria

In addition to the general inefficiencies caused by the different treatment of stamp duty on life insurance in each state and territory (as outlined above), there have also been recent developments which have further complicated matters for the superannuation industry. One such example relates to the recent changes to stamp duty in Victoria.

The 2014-15 Victorian State Budget stated that stamp duty would be abolished on life insurance policies, saving $4 million annually.

However, while the *Building a Better Victoria (State Tax and Other Legislation) Act 2014* (the Amending Act), which received Royal Assent on 17 June 2014, did abolish stamp duty payable on life insurance policies from 1 July 2014, the Amending Act also inserted new section 196A which defines what is considered *"life insurance"* – namely any insurance in respect of:

- a life or lives; or
- any event or contingency relating to or depending on a life or lives,

of any person living in Victoria at the time the insurance policy is issued.

Essentially, this means that:

- If a life insurance policy offers a payment of benefits on events that do not relate to or depend on life (such as disability or trauma), then these benefits are considered to be *"additional insurance"* (that is, a rider to a life insurance policy), which is taken to be general insurance and not life insurance; and
- Insurance duty – calculated as 10 per cent of the amount of the premium – applies to the *additional insurance* offered by *life insurance policy riders*.

Group Life policies within superannuation funds usually include death and total and permanent disablement (TPD) insurance. Communications issued by the Victorian State Revenue Office (SRO) and statements in the Duties Act Bulletin of June 14 D1/14 (the Bulletin) issued by that office make it clear that only death cover is seen as qualifying as life insurance. Disablement cover is treated as *additional insurance* and subject to stamp duty.

As a result of this interpretation, TPD cover offered by superannuation funds is classified as general insurance, and hence subject to stamp duty, even though it is classified as life insurance under the *Life Insurance Act 1995* (Cth).

ASFA believes that the reclassification changes outlined above are inconsistent with the government's policy intent. In his second reading speech which accompanied the Bill introducing these changes, the then Victorian Treasurer, Michael O'Brien, made the following statement:

> *"As announced in the 2014-15 budget, the government will also abolish duty on life insurance policies. This is an important measure on a number of fronts. Abolishing duty on life insurance policies will provide an annual saving of approximately $4 million per annum and will reduce the cost of life insurance for Victorian consumers. Moreover abolishing this duty will result in efficient and simplify benefits for the insurance industry overall. They will no longer have to deal with duty on two different types of insurance at two different rates. Instead, they benefit from the reduced administration and compliance costs of dealing with only one type of insurance duty – general insurance duty."*

ASFA contends that taking a benefit under a life insurance policy and calling it general insurance does not achieve any of advantages described in this statement. The changes will have the opposite impact on insurers, and the people who ultimately bear the cost of these changes will be Victorian members of superannuation funds.

One Victorian-based fund has advised ASFA that the cost of building the report to identify Victorian resident members and the duty payable by these members would be approximately $300,000. It can be expected that similar compliance costs would be incurred by other superannuation funds as well.

ASFA considers that the consequences that flow through to superannuation members is unacceptable and effectively imposes increased costs on Victorian members of superannuation funds.

The changes outlined above also have the potential to create a cross-subsidisation issue. Although the additional stamp duty costs are only attributable to Victorian resident members, it may be that superannuation funds will spread the cost to all members.

Appendix 7

Mythbusting superannuation tax concessions

The tax issues paper due to be released next week is likely to spark a lively debate regarding the equity and sustainability of superannuation tax concessions. Faced with an ageing population, a higher dependency ratio, and escalating pension, health and aged care expenditure, any government in power will face challenges in setting policies to accommodate the costs of supporting older generations throughout their retirement years.

While this debate is both welcome and necessary, it is important that discussions are based on and decisions are made in the context of accurate information, and not based on some of the myths that are perpetuated by inaccurate data, dubious analysis or assertions not backed by evidence.

In this context, this paper busts some of the key myths regarding superannuation tax concessions.

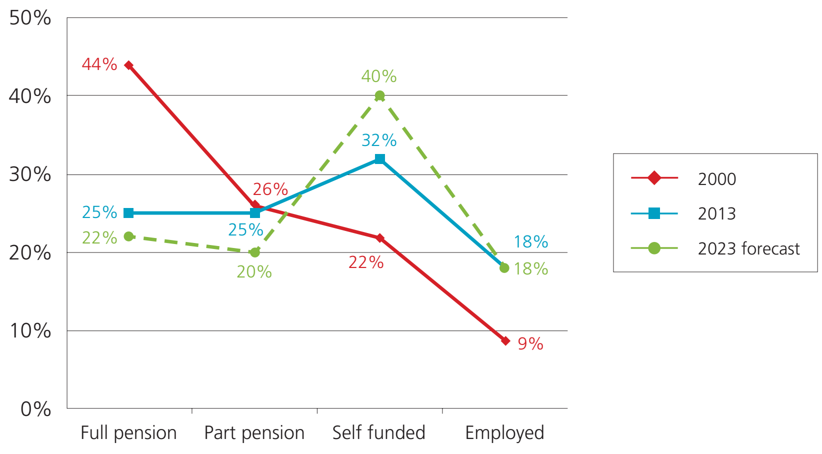
MYTH: Superannuation is not helping reduce the government's spending on the Age Pension.

FACT: Super saves the government $7 billion in Age Pension expenditure annually, and these savings will only increase as the system matures.

Superannuation is boosting incomes and providing a lifestyle in retirement that is better than that which can be sustained on the Age Pension alone. Around 32 per cent of those aged 65 in 2013 were fully self-funded in retirement, up from 22 per cent in 2000. We project this number will rise to 40 per cent by 2023. The recently released Intergenerational Report (IGR) acknowledges that reliance of younger retirees on the full Age Pension dropping. However, the figures it published do not show the reliance on the Age Pension falling as much as the numbers in chart below. This is because the IGR looks at all retirees (not just those turning 65).

One of the challenges still facing the system is ensuring retirees have adequate super in retirement, particularly in the later years of their retirement. Reforms such as increasing the Superannuation Guarantee (SG) from 9.5 to 12 per cent and the development of longevity products (reflecting that we are living longer) will further reduce pressure on the Age Pension.

Retirees at age 65



More than $7 billion a year is already cut from the Age Pension bill due to individuals having superannuation savings. This includes:

- around $3 billion in savings annually from around 160,000 people with super balances sufficient to be fully self-funded
- around $3 billion in savings from around 500,000 people receiving around $5,000 on average a year less from the Age Pension due to the income test on super income streams
- over $1 billion in savings from around 150,000 people, including many in defined benefit schemes, no longer receiving a part Age Pension because of the income test.

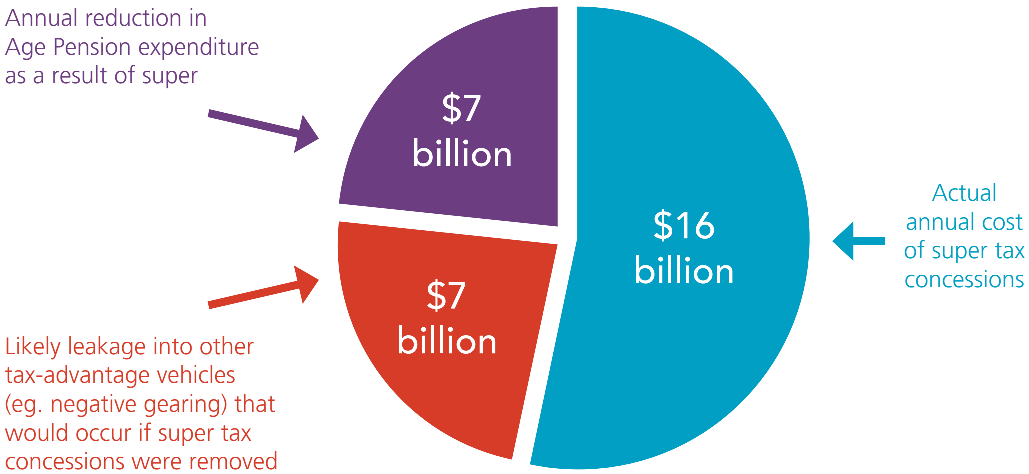
These amounts will increase in the years ahead as more Australians retire with substantial superannuation balances.

MYTH: Superannuation tax concessions cost the budget $30 billion annually – more than the total spending on the Age Pension.

FACT: The actual cost of tax concessions is around $16 billion a year.

When you take into account the savings the government makes on the Age Pension as a result of super, and the impact of behavioural change (people shifting money from one tax-effective vehicle to another) that would occur if super tax concessions were removed, a more accurate estimate would be around $16 billion a year. This is shown in the diagram below.

With the current legislated settings for the SG, expenditure on the Age Pension is projected to reach 3.6 per cent of GDP in 2054/55. In the absence of superannuation savings, expenditure on the Age Pension would be likely to reach 5.5 per cent or more of GDP and retirement incomes on average would be lower.



MYTH: The majority of government support for retirement goes to high-income earners.

FACT: Financial assistance for retirement provided by the government is broadly comparable across the personal income tax brackets.

All Australians receive financial support for their retirement from the government through either the Age Pension, tax concessions to fund their own retirement through superannuation, or a combination of both. When both of these forms of assistance are summed across a lifetime, all Australians receive around $300,000 across all tax brackets as a contribution by the government to their retirement. That is, everyone receives the same amount of assistance from the government – the only difference is the timing and vehicle through which it is delivered.

A lower-income person will receive this mostly in the form of the Age Pension, concessionally-taxed contributions and the low income superannuation contribution (while it still remains in place), while a person in the top income tax bracket will receive it as tax concessions for super. Many will receive a combination of all of these.

What's more, the amount of government assistance provided to individuals on very high income levels has been substantially reduced though lower caps for tax concessional contributions to super.

MYTH: The bulk of tax concessions for superannuation contributions go to high-income earners.

FACT: The bulk of tax concessions for superannuation concessional contributions go to middle-income earners.

Tax concessions applied to superannuation concessional contributions are not significantly skewed towards high-income earners, and, in fact, support the bulk of the working community to save for their retirement. ASFA analysis of data from 2011/12 found that around 75 per cent of the tax concessions applied to contributions went to those paying either of the (then) middle income marginal tax rates of 30 per cent or 38 per cent: those earning between $37,000 and $180,000 a year.

Taxable income range ($)	Share of total contributions (%)	Contributions	Investment earnings – accumultaion phase	Investment earnings – pension phase
$0 – $6,000	1	2	-0.4	0
$6,001 – $37,000	14	12	1	41
$37,001 – $80,000	43	38	35	29
$80,001 – $180,000	33	35	42	22
$180,001+	10	13	23	8

This shows that the contribution caps, which have been lowered substantially over the past few years, are working to reduce the concessional contributions made by upper-income earners, while continuing to provide support to the majority of Australians to help them save for their retirement.

However, some individuals have accumulated relatively high superannuation balances through contributions and transfers made before the contribution caps came into effect. ASFA has recommended that the tax treatment of very high superannuation account balances, in particular those in excess of $2.5 million that are in the pension phase, should be the starting point for discussions around ensuring the future equity and sustainability of the system.

MYTH: The most important tax concessions received by high-income earners relate to superannuation.

FACT: High-income earners get the most benefit from concessional capital gains tax treatment, negative gearing and exemptions for the family home.

The bulk of the wealth of high-net-worth individuals is in the form of shareholdings or property, both residential investment properties and commercial real estate. Around $360 billion in total is held in superannuation by those with more than $1 million in super. This is just over 20 per cent of the $1.6 trillion investable assets held by high-net-worth individuals.

For most high-net-worth individuals, tax arrangements relating to capital gains, negative gearing and the family home are likely to have more impact on the achievement and maintenance of wealth than superannuation tax concessions.

MYTH: Only high-income earners make salary sacrifice contributions.

FACT: Many middle-income individuals make salary sacrifice contributions.

Only around 35 per cent of employees with incomes above $150,000 a year make salary sacrifice contributions. Around 85 per cent of salary sacrifice contributions relate to employees with incomes below $150,000 a year. Over half a million Australians earning between $40,000 and $80,000 a year make salary sacrifice contributions.

MYTH: Most people take a lump sum from their super when they retire, spend it all on a big holiday or to pay off debt, then end up on the Age Pension.

FACT: The majority of superannuation assets end up in income-stream products when people retire.

There is no evidence that the majority of retirees are using their super to pay off debt or using a lump sum to fund the purchase of boats, cars and overseas trips before going on the full Age Pension.

In fact, only a minority of households have debt around the time of retirement (only 18 per cent of 65-69 year olds, falling to 6 per cent for those 70 plus), and even then, they generally have assets outside super which they can use to pay it off.

The vast majority of Australians are very sensible with what they do with their retirement savings. The great bulk of larger balances are retained in the superannuation system in order to generate ongoing income in retirement. In 2012/13, around $45 billion in superannuation assets were invested in phased drawdown income-stream products, compared to just $8 billion taken as lump sums.

MYTH: Compulsory superannuation has not increased household or national savings.

FACT: National and household savings have been substantially lifted by compulsory super.

The household savings rate has increased by around five percentage points from five per cent in 1992, when compulsory superannuation was first introduced, to around ten per cent in 2013/14. Some analysts have concluded that the household savings rate would only be two per cent in the absence of compulsory superannuation, as other developments have been driving the household savings rate down.

While there has been some offsetting reduction in voluntary savings because of compulsory superannuation, especially by higher-income earners, compulsory super currently is injecting an additional amount in excess of $35 billion a year into household savings, or 50 per cent of the total SG contributions flowing into superannuation.

MYTH: Government funds spent on superannuation tax concessions would be better directed at helping other areas of the economy.

FACT: Superannuation provides broad economic benefits that are the foundation for growth and prosperity.

Superannuation plays, and will continue to play, an important role in providing the foundations for economic activity and prosperity. It currently lifts household savings by around two percentage points of GDP or nearly $40 billion a year and, with the increase in the compulsory SG from 9.5 per cent to 12 per cent, this is expected to rise to 2.5 percentage points of GDP. This helps Australian businesses and governments to finance investment and infrastructure without having to rely unduly on foreign savings and investment. Higher levels of domestic savings reduce the cost of capital in Australia, increasing investment by Australian businesses which drives stronger economic growth.

Superannuation benefit payments, including lump sums, pension payments and insurance payouts, also boost domestic demand by over $50 billion a year, a figure which could quadruple by 2040 as more people move into retirement. The ageing population is expected to slow GDP growth, and, without superannuation, this reduction would be much greater. This is because superannuation provides business with the consumers of the future, delivering a boost to the economy which benefits all Australians.

Through their superannuation, all Australians have a stake in the Australian economy through the shares they own indirectly in the superannuation fund.

MYTH: Private superannuation savings could be confiscated.

FACT: Superannuation entitlements and account balances are strongly protected by law.

Some recent media reports have suggested that the current system of superannuation savings could be nationalised. These reports point to the introduction of measures which treat certain lost or inactive superannuation accounts as unclaimed with payment of the balances into consolidated revenue. However, the reality is that individuals can have any unclaimed superannuation monies paid into their active superannuation by simply applying to the Australian Taxation Office (ATO). This can be done in minutes by making use of the online facility provided by the ATO.

No political party in Australia has a policy which would involve the nationalisation of superannuation savings. In addition, Section 51(xxxi) of the Constitution of Australia limits the power of the Australian government in this area to "the acquisition of property on just terms from any State or person for any purpose in respect of which the Parliament has power to make laws." It is a constitutional guarantee of just compensation. Such a constitutional protection does not apply in some Eastern European countries where private pension savings have been nationalised.

The Association of Superannuation Funds of Australia Limited
Level 6, 66 Clarence Street, Sydney NSW 2000
PO Box 1485, Sydney NSW 2001
T +61 2 9264 9300 or 1800 812 798 (outside Sydney)
F 1300 926 484
W www.superannuation.asn.au
ABN 29 002 786 290 ACN 002 786 290