<u>Tax Review White Paper Submission</u>

Companies

(1) Eliminate profit diversion by multi-nationals (and large Australian companies with international operations) from Australia to other countries with lower corporate tax rates - by a combination of the following:
    a. Enhance compliance measures
    b. Use each companies global profitability rate (rather than their Australian profitability rates) to calculate the profit for goods and services sold within Australia
    c. Use "'deemed value added'' benchmarks to calculate the profit for goods and services sold overseas

Individuals

(1) Split individual taxable income into non-investment income (salary, pensions, etc.) and investment income (interest, shares, housing, superannuation, etc.). Then allow investment losses (negative gearing losses and capital losses) to be offset only against investment income (including superannuation earnings), with any non-offset investment losses to be carried forward to later years. This is an extension of the current treatment of capital losses which can only be offset against capital gains. It effectively abolishes tax erosion due to shifting of income from individual taxation rates to more favourable investment taxation rates. Note that salary and investment income do not need to be taxed using the same rates, although all investment income could be taxed using the same tax rates thereby treating all investments equally (tax wise).

(2) Change the capital gains tax deduction to more accurately reflect the impact of the CPI while the assets is held. The current figure of 50% is over generous, and 33% (which currently applies to superannuation capital gains) would be more accurate, and is based on the premise of gross capital gain at 3 times the CPI.

(3) Change the capital gains tax assessment, so that it is applied on an individual's average marginal tax rate over the period that the asset is held. The individual simply needs to provide the purchase price and date, as well as the sale price and date - the ATO has each individual's taxable income, assessed tax, and marginal tax rate histories. This treatment of capital gains is based on the rationale that the capital gain accrues over the whole duration that the asset was held, although it is realised when sold. This would eliminate the practice of tax erosion resulting from realising capital gains when an individual's marginal tax rate reduced, such as in retirement.

(4) Change the HECS system as follows (these changes would make HECS more sustainable by improving the percentage of HECS debt that is repaid, and would reduce people, without a reasonable likelihood of paying it back, from utilising HECS).

    a. Don't reduce the percentage of fees that are paid by the government
    b. Abolish the minimum repayment threshold (currently about $50K)
    c. Require people moving overseas to continue paying HECS
    d. Extend HECS style system to some other welfare payments

(5) Simplify the individual tax rates and brackets. Although this will not, in itself, be a positive for the economy, it will add set the way for individual tax rates to be aligned with other tax rates, such as company tax rates. The following tax rates and brackets would preserve the overall tax rate and (broadly) preserve the individual average tax rates: $0k-$15k (0%), $15k-$25k (10%), $25k-$35k (20%), $35k-$75k (30%), $75k-$150k (40%), $150k+ (45%). These tax rates and brackets provide a marginal tax rate below the company tax rate up to $75k, and an average tax rate below the company tax rate up to $150k.

Superannuation (and Pensions)

(1) Calculate the lifetime retirement benefit (from retirement tax concessions) that each individual receives and cap the total lifetime benefit that each individual receives the cost of providing the Aged pension. This cap could be means tested, and be reduced for higher income earners.

(2) Tax superannuation contributions earnings in accumulation phase at the individuals "average" income tax rate, so as to:

   a. Provide a rate below the marginal tax rate for individuals as compensation for the time value of locking up superannuation savings,
   b. Provide the Government with an overall superannuation tax take equivalent to the overall income tax take, i.e. about 22.5% as opposed to the current 15.0%.
   c. Reduce the distortion whereby the bottom 20% of income earners are tax-disadvantaged by superannuation (refer to Treasury distributional analysis of superannuation tax concessions)
   d. Reduce the distortion whereby the top 20% of income earners receive a tax concession above what it would actually cost to simply provide them with the full aged pension (refer to Treasury distributional analysis of superannuation tax concessions)

(3) Tax superannuation earnings in retirement phase (on a concessional basis), as all other forms of earnings are taxed.

(4) Don't tax superannuation pensions, as they are just a transfer of fully taxed assets from an individual's superannuation account (to the individual)

(5) Allocate a portion of the additional superannuation tax collected (by using average tax rates rather than 15% tax rate), to provision for individuals with no superannuation and to individuals with little superannuation. One model would be to establish a Retirement Fund (comparable to the Future Fund and which invests similarly to large public superannuation funds) with $1500 being contributed for each of the 5 million individuals not in the labour force i.e. $7.5billion per year, and to provide a co-contribution beginning at $1500 for individuals with the lowest taxable incomes and progressively phasing out at the median taxable income i.e. $3.75billion per year. When fully mature (45 years), the Retirement Fund could provide 50% of the cost of providing the aged pension for individuals with no superannuation, and would provide a significant boost to the retirement income for individuals with the lowest taxable incomes. Note that providing tax concessions to individuals who will not qualify for the aged pension has a zero efficiency, for individuals who will qualify for a part aged pension has a 50% efficiency, and for individuals who will qualify for a full aged pension has a 100% efficiency. This is why the current superannuation system is failing to reduce the cost of providing the aged pension by anywhere near enough, and the problem will only worsen and the tax concessions for superannuation earnings grows.

(6) Impose maximum limits on TRPS, Lump Sum payments, and superannuation pension payments – to eliminate the problem that a considerable portion (or even all) superannuation benefits can be squandered before (or shortly after) an individual becomes eligible for the aged pension. For TRPS, impose a maximum limit that reflects the actual reduced hours worked.

(7) Reform superannuation fees to world best practice (similar to the New Zealand experience) and impose penalties on public superannuation funds that impose fees well above the median. The CSS Superannuation Fund and the Australian Superannuation Funds 'balanced' fund strategy was to deliver earnings 3% above CPI, which has been delivered over the long term (25 plus years). Therefore, there is no excuse (apart from high fees) for other public superannuation funds, which use the same asset allocation and investment strategies for their 'balanced' fund strategy, yet consistently deliver some 3% less in annual returns to fund members. This is an issue for Government involvement, as higher fees result in lower superannuation pension which in turn result in greater aged pension liabilities – in effect the Government foots the bill for 50% of superannuation fees through higher aged pension liabilities.

(8) Reduce the risk associated with superannuation, and thereby reduce the risk to the Government of needing to provide additional aged pension payments by implementing the following steps:

a. Don't allow superannuation for any purpose other than retirement income
b. Don't allow superannuation fund borrowing
c. Monitor and investigate funds with very low and very high risk profiles (especially public funds)
d. Provide infrastructure bonds (only available to superannuation funds, especially in retirement phase) offering an investment return of CPI plus 3% (say)

(9) Progressively phase out the existing tests and replacing with them with an income test based on superannuation income, as the superannuation system matures. This will, in effect, reflect the individuals' lifetime taxable income (adjusted for lifetime superannuation investment return), rather than choices regarding whether the individual spent/saved their lifetime taxable income, as well as eliminating incentives surrounding asset and income planning in retirement as well as problems such as downsizing the primary residence.

(10) Retain the aged pension eligibility income test basic design, whereby the aged pension progressively reduces at a fixed rate.

The attachment (below) provides more detailed analysis of Superannuation and Pensions.

State Taxes and GST

(2) Pool and distribute mining royalties (collected by individual states) across all states, using the typical states grants allocation formula. This may seem a difficult proposition, especially as states have a history of placing their own interests first, second, and third. However, changing the GST allocation and other Federal grants allocations would provide an equitable allocation of the total revenue. Also, now that the so called mining boom has finished, may provide the best opportunity for this reform. The benefits from this reform would include (1) avoiding the situation of a two speed economy (mining states vs non-mining economies), which complicates problems of managing economic settings at a Federal level, (2) allowing all individuals to share equally in the wealth created from exploiting what is a national asset, (3) smoothing the boom/bust cycle of mining states. The maligned MRRT was actually a good idea, ruined by a

stupid implementation. Essentially the MRRT should be incorporated in the formulation of mining royalties, rather than a separate tax (and by a different jurisdiction).

(3) Extend the coverage of the GST to all goods and services (including overseas goods and services), with a corresponding reduction in the rate of the GST (so that the overall change was broadly revenue neutral). That is increase coverage by 100% and reduce the rate by 50%. This has several benefits – stop ongoing erosion as well as restore past erosion of GST as a percentage of GDP, overall GST per individual would be mostly unchanged, compliance would simpler, and GST revenue would improve (from stopping claims for GST concessions for non-GST items). This change would have widespread support. It would be a mistake to equate GST reform with GST increase – as GST increase will not have widespread support. That is because GST, while a flat tax on consumption, is a regressive tax on individuals, since lower income individuals have less capacity to save so are more impacted by the GST than higher income individuals.

(4) Incorporate the multitude of non-GST consumption taxes into the GST (by commensurately increasing the rate of the GST) and abolish the non-GST consumption taxes. This will mean that the GST is applied at more than a single rate, and concession exemptions need to be thought through. However, this complexity would be more than offset by the removal of the complexity that half goods and services are liable for GST while half are not (consider the case of pizza rolls raised in the Tax Discussion paper). Replacing existing consumption taxes with a GST does not replace a progressive tax with a regressive tax, as consumption taxes are already regressive. The original GST was designed to replace existing consumption taxes, so this submission is an extension that. The following taxes should be considered

   a. stamp duties
   b. alcohol taxes
   c. tobacco taxes
   d. luxury car taxes
   e. fuel taxes
   f. other state consumption taxes

   In fact, virtually all state taxes (including payroll tax, which is not a consumption tax) could be eliminated with a GST tax levied at 10% on all goods and services. Obviously, payment of the additional GST would need to be wholly conditional on the abolition of other consumption taxes (unlike what happened when the original GST was introduced).

   There may be a case to maintain some taxes separate to the GST and/or offset part of the otherwise increase in the GST, such as:

   a. land taxes (increased to partly offset the abolition of stamp duties)
   b. vehicle taxes (increased to partly offset the abolition of stamp duties)
   c. rates
   d. agricultural (and other industry specific) levies

(5) The Tax Discussion Paper compared the Australia GST with the consumption taxes in other countries. This is not valid, as it should compare the total of all consumption taxes in Australia with the total of all consumption taxes in other countries. Also, just because most OECD individual's lifetime. This is not valid, as while it is flat in terms of consumption it is regressive in terms of individuals and wealthy individuals do not consume all their income over their lifetime,

and pass it on in the form of inheritance, both while alive and in their estate. It is necessary to consider these factors when assessing the recessive impact of the GST.

<u>Climate Change and CO2 Reduction</u>

(1) Implement a levy on all fossil energy at the source of production (based on its CO_2 emissions). The cost is likely to be significantly less than $5 per ton of CO_2 emissions or $100 per household equivalent. This would include all fossil energy produced in Australia, including exported fossil energy.
(2) Allocate the levy funds to three targets (say 50%, 25%, and 25%) allocating to individual projects so as to maximise Cost/CO_2 reduction
    a. RET target
    b. Abatement target
    c. Research target
(2) Don’t allocate any levy funds for compensation
(3) Phase out fossil energy subsidies

<u>Attachment: Australian Retirement System</u>

<u>1 Purpose</u>

The purpose of the Australian Retirement System (retirement system) is to provide people with an adequate income stream during retirement.

<u>2 History</u>

Historically, people spent their working life without making superannuation contributions, then retired from the workforce and received an aged pension to provide an income stream during their retirement. The aged pension was means tested (income and assets) to provide a measure of fairness, as well as reduce the burden on the Budget.

In the 1980's, it was concluded that the demographic ageing of the population combined with increasing life expectancy, meant that the retirement system (as it then was) would eventually become unsustainable. In 1992, a combination compulsory/voluntary 'provisioning' system (superannuation) was introduced. The basic design was that people would contribute compulsory percentage of their taxable income supplemented with additional (capped) voluntary contributions to provide a superannuation pension in retirement, which would be supplemented with a means tested aged pension. The compulsory level was 3% in 1992, and increased to 6% by 1996, then 9% by 2002, with 12% planned by 2025 (with it currently standing at 9.5%). The eligibility of the aged pension is planned to tighten from 65 years to 67 years by 2023, and then 70 years by 2035. The (standard of living) level of the aged pension is planned to reduce as a percentage of AWE (and TMAWE), although the (buying power) level of the aged pension is planned to remain benchmarked to the CPI.

This ongoing erosion of the retirement system (so that it is sustainable) is undesirable and reflects an inadequately designed retirement system. While it is true that the population is demographically ageing and life expectancy is increasing, and economic circumstances change – these can be estimated and modelled sufficiently accurately, such that ongoing modifications to the retirement system (which can undermine public confidence) is unnecessary. The analysis in this report provide an understanding of where the retirement system is working well, and where it is not working well, and provides a number of recommendations.

<u>3 Principles</u>

It is important to set out a set of the principles that underpin the retirement system. This has not been done sufficiently within the political system, because there is been too little effort on the cooperative aspects of politics. This report lists and discusses the principles of the retirement system, and which need to be discussed and analysed.

3-1 Design

The basic design of the retirement system is can be summarised as follows:

(1) Compulsory superannuation saving used to provide a superannuation pension

(2) Voluntary superannuation saving used to supplement the superannuation pension

(3) (Means tested) aged pension to provide a safety net to supplement the superannuation pension

There is a mistaken perception that that superannuation is designed to supplement the aged pension, rather than the other way around. Even Treasury does this (refer to the Charter of Superannuation report). Unfortunately, this perception conveys the message that aged pension is the primary source of retirement income, hence all individuals should be entitled to the aged pension, and that superannuation is then a top-up for the aged pension.

The retirement system before superannuation, and even the current retirement system, is a 'Ponzi' scheme. Individuals in the work force contribute to the scheme via taxes. People in retirement withdraw from the scheme via the aged pension. This works well until the withdrawals begin to exceed the contributions (due to the demographic ageing of the population and longer life expectancies). Superannuation is a provisioning system that will (eventually) reduce the withdrawals from the scheme. If one third of the working age population contributes no superannuation (in any year) then a significant portion of the working age population will have insufficient superannuation pension to provide a superannuation pension at least at the level of the aged pension. To provide a fully sustainable provisioning system, every working age individual needs to provision sufficient superannuation savings to provide a superannuation pension at least at the level of the aged pension. This is a challenge.

The retirement system is intergenerational' theft, on a massive scale. Individuals in the work force are paying for the retirement of the so called previous generation - currently, this amounts to some $40B each year, and growing rapidly. To break this cycle, someone has to both provision for their own retirement, as well as meeting the bill for the previous generation. That is why superannuation is a long term strategy, as individuals cannot afford to immediately do both. This adds to the challenge.

The Government provides tax concessions for individuals contributing to superannuation. For the individual, the advantage is clear – it boosts their superannuation pension. For the Government, it costs the same no matter who receives the tax concessions. However, the Government will receive

1. no benefit from tax concessions to individuals who can accumulate sufficient superannuation (so that will not receive any aged pension)
2. a 50% benefit from tax concessions to individuals who can accumulate insufficient superannuation (so that they will receive a part aged pension)
3. a 100% benefit from tax concessions to individuals who can accumulate no or very little superannuation (so that will receive a full or nearly full aged pension)

Therefore, the best strategy is to divert superannuation tax concessions to individuals with no (or little) superannuation. Basically, the current superannuation system has failed because it does not follow this strategy, and as a consequence, the pension liability has continued to spiral out of control. This will continue, and eventually, the Government will be forced to make change strategy.

This can be done in two possible ways.

1. Establish a Retirement Fund (something similar to the Future Fund), as a provision for current and future pension liabilities

2. Ensure every individual has a superannuation account, and provide co-contributions to all individuals with no or very little superannuation (for that year) – likely on a sliding scale with the most going to individuals with no superannuation and phasing out as the amount of superannuation increases.

The Government receives an additional benefit from diverting tax concessions to pension provisioning, through the compounding of the earnings above the CPI, which can be substantial over an individual's working life.

3-2 Taxpayer Costs

The total cost to taxpayers is made up of Budget expenditures for

(1) Tax concessions for compulsory contributions

(2) Tax concessions for voluntary contributions

(3) Tax concessions for superannuation earnings

(4) Co-contribution payments

(5) Aged pension payments

There are multiple methods for calculating the cost of superannuation tax concessions.

(1) The revenue forgone method - assumes the continuation of the concessional taxation treatment of superannuation. It operates on the assumption that, if the super system did not exist, wages and salary currently being contributed to super would be paid directly to employees and taxed at their respective marginal rates. That is, it assumes that if super did not exist, and there is no alternative universal saving mechanism where taxpayers could enjoy concessional tax rates of 15 per cent. The money otherwise contributed to super would either be spent or invested and taxed at marginal rates. The revenue forgone method assumes no behavioural change (that is, it does not take into account the likely use of other ways to reduce tax).

(2) The revenue gain method — assumes that contribution and earnings concessions cease on a particular date and examines the cumulative consequences of relatively lower contributions and assets. Under the revenue gain method, regard is had to the likely behavioural change that would see taxpayers using other strategies to reduce tax, such as negative gearing. This approach measures how much revenue could increase if a particular tax concession were removed. For example, under the revenue gain method, it is assumed that voluntary concessional contributions (that is, non-Superannuation Guarantee concessional contributions) and most non-concessional contributions would not be invested in superannuation. Voluntary contributions are assumed to be directed to alternative tax preferred investments. Because more voluntary contributions come from those with higher marginal tax rates, the average tax rate for residual compulsory contributions would be lower.

(3) The average tax rate method – assumes that without superannuation that tax brackets would be shifted, so that the Government received the same average percentage of the total taxable income i.e. roughly 22%. Similarly, individuals would pay the same average rate of taxation for superannuation as they currently do for their taxable income. This method is based on the underlying assumption that without superannuation, tax

brackets would be re-positioned, so that the Government received the same percentage tax as they currently do from ‘the total individual taxable income i.e. roughly 22%, and can be considered to be revenue neutral (in this sense) for the Government.

The overall superannuation tax rates using each of these methods and the current method are as follows:

(1) The ‘’revenue foregone’’ rate is 36%

(2) The ‘’revenue gain’’ rate is 28%

(3) The ‘’average’’ rate is 22%

(4) The ‘’15%’’ rate is 15%

The main criticism of the first method is that it would grossly overestimate what could be considered the actual tax concession, and it is unfortunate that this is the figure that is commonly reported. The second method provides a more accurate measure of the actual tax concession, but it does not consider any impact from the Government adjusting tax brackets, so as to maintain an overall 22% tax take of taxable income, and it is complex. The third method provides a less accurate measure based on the existing tax brackets, but does provide an accurate measure, based on existing tax brackets being adjusted, so as to maintain an overall 22% tax take of taxable income.

3-3 Individual Costs

The total cost to an individual is made up of

(1) The cost of their own contributions (which can be considered foregone salary)

(2) Their share of taxpayer costs - tax concessions for compulsory contributions, tax concessions for voluntary contributions, superannuation earnings, co-contribution payments, and the aged pension payments.

Superannuation contributions are currently set at 9.5% and planned to increase to 12% by 2025. There is broad agreement on the contribution level, but not the timetable. As contribution costs are (ultimately) borne by the employer, it is difficult to understand why the rise in the standard of living component of the annual AWE increase (i.e. AWE minus CPI) is not simply allocated to increasing the level of superannuation contributions, until the 12% target is reached.

3-4 Administration Costs

The major administration cost is fees charged by Superannuation Funds – for ongoing administration and to manage investments. The costs of fees does have a huge impact on the superannuation pension level.

Studies show that Australia is far from world best practice for fees and that some countries have managed significant reductions in fees, e.g. Chile reduced fees by 90% and New Zealand reduced fees by 55%. Anecdotal evidence shows that there is considerable difference in the post-fee investment return to members, even when the superannuation funds use very similar investment strategies. High fees not only reduce the superannuation pension for individuals, but also increases the amount of aged pension needed to supplement the superannuation pension, and so impacts Government as well. It is difficult to understand why a proper effort has not made to implement fee reforms that have been successful such as in New Zealand, or to reduce the investment return discrepancy between large superannuation funds that employ essentially the same investment strategy (e.g. comparing 'balanced' investment options across funds).

3-5 Contributions

The level of superannuation pension depends upon many factors:

1. Level of contributions
2. Length of time contributions are made
3. Level of investment returns
4. Level of taxation of contributions
5. Level of taxation of investment earnings
6. Level of administration fees
7. How long the superannuation pension needs to last

Contributions detract from an individual's disposable income, so decreases their standard of living. That is why the level of contributions has steadily increased since 1992, as the standard of living has increased, and now stands at 9.5% with a proposed increase to 12% by 2025. Therefore, individuals can sustain a current level of 9.5% which will increase to 12% by 2025. The Analysis shows that most individuals can reach a satisfactory superannuation pension with this contribution, under reasonable long term economic settings.

3-6 Taxation

What should be taxed?

Superannuation contributions, earnings, and pensions are all available to be taxed, and in any combination. From the Government viewpoint, it makes most sense to tax contributions and earnings, as this provides taxation revenue at the time of contribution and earning, whereas taxing pensions requires the Government to wait 40 or more years to receive its taxation revenue. Delaying taxation revenue would place considerable strain on its budget. From the individual viewpoint, it makes most sense to tax superannuation pensions, as this delays the timing of taxation payments thereby benefiting from higher superannuation balances and the extra earnings that ensue. If contributions and earnings are fully taxed (at concessional rates), then it is unfair to then tax pensions as well, as this would be double taxation. It is difficult to understand the rationale of taxing superannuation pensions from age 55 to 60, and then not tax pensions after age 60. It is also difficult to understand why earnings would be taxed to preservation age, and then either taxed or not taxed depending upon whether a pension is being drawn. Note that the aged pension income test should include the superannuation pension (in retirement phase) in the income means test.

How much tax should be raised overall?

This report asserts that the "average" taxation method should be applied. For the Government, it is revenue neutral – in the sense that they receive the same percentage tax take as the income tax from personal income. For individuals, it is the represents tax level they would achieve if they were able to divert superannuation contributions to other tax advantaged investments so as to lower the tax from their marginal rate to their average tax rate. For 2011-12, the overall tax rate was about

22%, which would raise some 50% more tax than the “15%“tax method. Considering that superannuation taxes currently raise $20B, then the tax concessions (calculated using the “average” method) would amount to some $10B.

How much each individual should be taxed (what is fair)?

This is simple enough:

1. Individual should not be disadvantaged by being worse off under superannuation
2. Individuals with lower taxable incomes should not receive less in total retirement benefits than individuals with higher taxable incomes (i.e. superannuation tax concessions plus aged pension payments)
3. Individuals should not receive more in retirement benefits, than the cost of providing the full aged pension.

Low taxable income individuals with an effective marginal tax rate of 2% are be penalised with compulsory contributions being taxed at 15% (without the low income co-contribution which is due to be abolished in 2017) and are penalised with earnings being taxed at 15% (even with the co-contribution in place). The aged pension will offset only half the reduction in pension, as the pension reduces by 50% of the retiree’s taxable income between about $4,000 and $44,000. The attitude that these people will need to rely on the aged pension anyway, is cruel, as they are only 50% compensated to the disadvantage of compulsory contributions. That is, they are actually worse off with superannuation, even with the co-contribution in place.

Analysis of the total (lifetime) retirement benefit for the full range of taxable incomes, under reasonable economic conditions (3% CPI and 6% investment returns) shows that individuals do receive progressively lower retirement benefit over their life time for taxable incomes up to about $150K, then the retirement benefit increases quite dramatically, even when the tax concession benefit is measured using the “average” method (which is the most conservative measure). If voluntary contributions and non-concessional contributions are included, the increase in the retirement benefit for high taxable income individuals is more pronounced.

Individuals with a marginal tax rate of 47% can expect to receive a total retirement benefit (via tax concessions) well in excess of the amount that they would receive even if they were simply paid the full aged pension, even with the 15% surcharge for incomes over $300K, and without utilising the voluntary concessional contribution limit ($30K), the non-concessional contribution limit ($180K), and TRPS. The same is true, but to a lesser extent, for people on a 39% and 34.5% top marginal tax rates - with the assistance of the voluntary concessional contributions limit ($30K) and non-concessional contribution limit ($180K), and TRPS

The contention that a flat superannuation tax rate is necessary (otherwise it would be too complicated) is not valid. Firstly, individual income is taxed using a progressive tax rates, and is not deemed too complicated as well as being fair. How can a progressive tax rate be deemed not too complicated and fair for individual income, and at the same time deemed to be too complicated and not fair for superannuation? Individual tax payments are based on a PAYG schedule and an balancing adjustment is undertaken as part of the tax assessment process. It is difficult to understand why the same can be undertaken for superannuation contributions and earnings.

3-7 Investment Returns

Sensitivity analysis shows that superannuation investment returns, after fees and taxes, have a large impact on the superannuation pension. A 15% contribution tax will decrease the part of the superannuation pension resulting of contributions by 15%. A 15% earnings tax will decrease part of the superannuation pension resulting from earnings considerably more than 15%. Fees also reduce the part of the superannuation resulting from earnings more considerably more than 15%, even if the fees are equivalent to 1% of the superannuation balance. Also, an individual can expect about 25% of their superannuation pension to result from contributions and 75% to result from earnings, given reasonable economic conditions.

Published investment returns for large public superannuation funds shows considerable differences in the returns reported to superannuation fund members, even when the public superannuation funds used essentially the same investment methodology (e.g. comparing each funds balanced fund option). The CSS Superannuation Fund and the Australian Superannuation Fund employ a strategy to provide an investment return after taxes and fees 3% above CPI, and both funds have exceeded this benchmark over the long term. The question then rises – why many large public funds, particularly 'retail' superannuation provide long term investment returns some 3% below those of CSS and Australian Super.

Basically, the answer is fees. These funds provide lower investment returns due to higher fees. This is not just bad for the superannuation fund member, who will end up with a lower superannuation pension. It is bad for the Government, who will need to pay considerably more in the form of the aged pension to these superannuation members. Essentially, the Government is bearing 50% of the cost of higher fees. Hence, it is in the Governments own interest to reform and cap superannuation fees, even if they have no concern about individuals being denied a more adequate retirement income stream from their superannuation pension.

3-8 Pension Payments

This current superannuation pension payment rules are very poorly designed. Potentially, individuals spend their working life contributing something like 10% of their taxable income to superannuation. The Government (i.e. taxpayer) contributes in the form in the form of tax concessions and/or co-contributions. For the individual, the sole purpose of all this effort is to provide an adequate income stream for the duration of the individual's retirement (supplemented with a zero/part/full aged pension). However, it is possible to consume a significant portion (or even all) of the accumulated superannuation balance for purposes other than providing an income stream for the duration of the individual's retirement, which is outrageous.

TRPS allows individuals to withdraw up to 10% of their superannuation balance each year for 5 years prior to retirement at 65 years. For low taxable income people, this can consume a significant portion of their superannuation balance. The concept that people should be able to reduce their work hours (after preservation age) and start a superannuation pension is sensible, but the maximum TRPS pension rate needs to be based on the pension lasting the individual for 20 years. Additionally, I am unaware whether there is any Audit requirement that individuals actually do reduce their work hours and that the TRPS pension is commensurate with the actual reduction in work hours. This means that TRPS is used as a tax shelter, and most accountants advise their clients must have 'rocks in their head' to not use TRPS. No doubt is unpopular to restate that - the sole purpose of all superannuation is to provide an adequate income stream for the duration of the individual's retirement, which is supplemented with the safety-net aged pension.

Lump Sum payments allow individuals to withdraw up $185K tax-free and additional amounts can be withdrawn as lump sums (subject to tax). For low taxable income people, this can consume a significant portion (or perhaps all) of their superannuation balance. The concept that people are able to withdraw a portion of their superannuation tax-free is sensible, however, this report makes the point that all superannuation pension should be tax-free, as contributions and earnings have been fully taxed and the superannuation pension is an asset transfer. This would eliminate the incentive to withdraw a lump sum to obtain the tax-free benefit. The other reasons for lump sum payments would include – paying off debts, house renovations, purchases such as a new car, and a lifetime world holiday, and laying the groundwork to be eligible for the full aged pension. No doubt is unpopular to restate that - the sole purpose of superannuation is to provide an adequate income stream for the duration of the individual's retirement, which is supplemented with the aged pension. Again, lump-sum payments need to be capped in the context that the superannuation pension needs to last for at least 20 years.

Individuals are allowed to withdraw any amount above the mandated minimum pension amount each year. It is difficult to understand why there would be a mandated minimum amount and no mandated maximum amount, rather than the other way round. There should no requirement to withdraw any minimum amount, although there is a need to define a deemed withdraw amount for the purpose of applying the income test for aged pension eligibility (that would apply for withdraw amounts below the deemed amount). A maximum withdraw amount needs to be mandated, so that the pension will last for the persons retirement. The analysis shows that a 7.5% pension rate (based on the pension start date balance) would provide an income stream for about 20 years. Additionally, the provision of Government infrastructure bonds - with investment return set at (say) [CPI/2+AWE/2+3]%, could offer certainty that the income steam would actually last 20 years, and would be attractive, especially individuals with lower taxable incomes, as it reduces longevity risk.

It is difficult to understand the Government would provide enormous taxpayer funding for the superannuation system via tax concessions - to reduce the pressure on the aged pension, and then allow significant portions of individual's superannuation balances for purposes that completely undermine the whole effort. This is particularly acute for people with lower taxable incomes, where their entire superannuation balance can disappear by the time they become eligible for the aged pension.

3-9 Control and flexibility

Superannuation tax concessions (to individuals) can be provided by applying reduced tax rates, by making co-contribution payments, or by setting up a Government retirement fund (funded with the tax concessions). The co-contribution method is undoubtedly superior to the reduced tax rate method. This is because it is simple to precisely target the amount of tax-concession to each individual as well as keep track of the cumulative amount of tax concession that each individual has received. Also, reduced tax rates do not provide a tax concession for individuals with no superannuation contribution. Lastly, the tax reduction method suffers from the ongoing problem that superannuation earnings will progressively and significantly increase (relative to contributions - which remain relatively static in real terms), so placing an ever increasing burden on the level of tax concessions. It is difficult to understand why the current system has chosen the reduced tax rate method.

3-10 Economic Impact

The superannuation system creates a very large pool of savings, which will keep increasing until the system 'matures' (when every working person and every retired person spent their whole life in the system and the increases in the SGC have fully flowed through). This large pool of savings has the potential to benefit the economy enormously, yet it is difficult to understand why so little has been done to realise this potential economic benefit. One simple strategy would be to establish Infrastructure bonds (only open to superannuation funds) and use superannuation savings as a source of funds for infrastructure projects. This would provide enormous economic benefit, as well as providing a secure low risk investment with good investment returns for superannuation funds – just look at the performance of Infrastructure fund type companies listed on the ASX.

3-11 Public confidence

Public confidence is eroded by

1. Situations where they are worse off than if they simply did not have superannuation
2. Situations where higher income people receive more retirement benefit than lower income people
3. Situations when anyone receives more than the full aged pension equivalent in superannuation tax concessions
4. Constant changes to the system, especially negative ones and/or retrospective changes.

3-12 Risk

Superannuation is by definition a long term investment, which requires a low risk long term investment strategy that aims to provide an investment return (say) 3% above CPI.

The ability of superannuation funds to leverage (via LRBA loans) increases the risk to individuals (who can lose the large single asset being leveraged, as well as the superannuation system. This was the conclusion of the FSI. This must be contributing to the current housing bubble, without contributing much to the economy. Furthermore, there is a proposal to allow superannuation funds to leverage even more, by allowing people to use superannuation to purchase their home (which has already been made more expensive courtesy of the LRBA). This is a clear example of confused signals rather than a clearly articulated principle.

There is a structural risk from the ever increasing tax concession burden placed on the Government (i.e. taxpayer). The contribution level will increase from 9% to 12%, which will increase the tax concession on compulsory contributions by 33%. However, as the superannuation system matures (over the next 75 or so years), the tax concessions on superannuation earnings will increase considerably. Currently, it is slightly more than the tax concessions on contributions, but will more than double (in real terms).

There is an investment performance risk for both individuals and the retirement system. If superannuation funds are engaged in very high risk investments, there is the potential for large losses. Alternatively, if superannuation funds are engaged in very low risk investments (i.e. term deposits) there is a different risk that the investment performance will not keep pace with CPI. One measure that would improve the risk of failures would be to provide an ongoing risk category score for each individual super fund, and to investigate those superannuation funds considered very high risk. This could be completely automated.

There is a longevity risk for both individuals and the Government. If economic conditions change significantly when individuals are in the retirement phase, then a sudden downturn can adversely impact on the length of time their superannuation pension will last (at the current pension level).