Tax White Paper Task Force
The Treasury
Langton Crescent
PARKES ACT 2600

bettertax@treasury.gov.au

Date 20 July 2015

A New System for the Taxation Equivalency of Retirement Wealth

Not everyone uses superannuation to accumulate and pay a stream of retirement income. There needs to be a New System for the Taxation Equivalency of Retirement Wealth ("New System").

Compulsory Superannuation Guarantee/mandated contributions, earnings and benefits should be taxed concessionally. Taxes for all future discretionary investments in asset classes/investments products – including discretionary superannuation - used to accumulate retirement wealth should be consistent/equitable as a package across the investment type.

There would be (when taken as an overall package) an equivalency of tax rules on earnings, distributions/income, benefits and gains across all discretionary investments: discretionary superannuation simply becomes one of the types of discretionary investment. There would be no tax advantage or disadvantage to any discretionary investments: be they negatively geared assets or whatever! This equivalency would need to be at the investor's inputs level (e.g. non-super tax deductions vs super concessional contribution input tax rate) and outputs level (e.g. earnings vs dividend vs distribution/investment income vs capital gain vs super payments).

Universal treatment of assets for eligibility for old-age-pensions would give no advantage to any one investment type over another.

For <u>future</u> superannuation.

- There would be greater tax incentives for contributions, earnings and benefits resulting from compulsory Superannuation Guarantee (SG)/mandated contributions up to the SG based on the prescribed SG Maximum Contributions Base (MCB), with that MCB based SG being the universal concessional cap.

  The Henry Tax Review recommendation is plausible, being to tax concessional contributions at an individual's marginal tax rates less a rebate, so for some, a higher tax on contributions than the current rate.

- Above prescribed SG/mandated contributions there would be less advantageous than SG/mandated tax treatment of contributions (e.g. a less generous rebate) and earnings and benefits.
- Superannuation benefits would have a significant proportion paid as income streams, with limited lump sums permitted.
- Superannuation benefit taxes would apply at all ages, the actual rates being set so that allowing for compulsory preservation and being an income stream, there is equivalence as a package with non-superannuation assets without those compulsory attributes.

To recognise that there not be retrospective tax changes for any pre-existing asset classes/investment types:

- A pre-New System superannuation component would remain for accumulated/accrued benefits to the change date - generally retaining the pre-New System tax regime for benefit payments. Future earnings would be taxed as for the New System.
- Similarly, any other tax advantaged pre-existing non-superannuation investments remain with their legacy tax rules until the asset is realised.

An alternative that I have explored but dismissed is to start the superannuation system from afresh, with a universal accumulation based system across the private and public sectors (including politicians and statutory positions to apply a community standard!). Although a pre-change/legacy component would remain for superannuation accumulated to date, my analysis is that starting afresh would entail too many idiosyncrasies to be "general exemptions".

David Woodhouse

Disclaimer: This submission is solely the views of the author who remains responsible for its content. It is not attributable to any other person or entity.

A New System for the Taxation of Retirement Wealth

Background

Creation of retirement wealth is not limited to superannuation. Not everyone is covered by the Superannuation Guarantee. Some prefer to invest external to superannuation in any case, through whichever asset class that suits their risk profile. After recognising that superannuation has compulsory preservation and (as I propose) being predominantly an income stream, there should be equivalency as a package in the taxation treatment of all discretionary retirement wealth investments - both their accumulation and the income generated in retirement: a person's risk profile should not be the determinant for the tax reward that applies.

It is often advocated that the panacea for Federal government budgets is increased taxes for and/or lesser contributions to superannuation, with restrictions on negative gearing for property - other geared asset classes are often not referenced! Proponents and respondents are generally not impartial, believing their investment type should be advantaged, but other investments should not be. Governments want fiscal solutions now.

Superannuation Guarantee is compulsory only to the SG Maximum Contributions Base, subject to any permitted exceptions. It is inappropriate for a government to tax compulsory savings the same as any discretionary savings.

Superannuation investments are not an asset class: the investment strategy is effected through a homologation of selected asset classes. Yet the effective tax on discretionary superannuation investment assets differs to the tax on non-superannuation assets.

Accumulated savings should not be seen as a pool to provide current fiscal solutions. Compulsory and discretionary investments are entered into based on the rules permitted at the time, with the accumulated or realisable value or income stream at any time being based on the rules and market forces validly applicable during the period of investment. Increasing the future tax payable when realising those validly accumulated amounts would be retrospective. The tax on future earnings of existing investments could arguably be amended, as those earnings are not yet vested in the investor: some transition rules may be required to not retrospectively amend capital gains tax rules.

My model assumes there could be an increase in some future superannuation taxes and so reverts to pre-July 1993 and pre-July 2007 concepts to clearly distinguish the past accumulated and vested amount from the future without being exposed to retrospectivity. It would take decades to be fully in place until the last of those with pre-New System superannuation meet a condition of release, more generally "retirement", and their benefits paid. Non-superannuation investments generally would not have the same duration. Overall, no quick fiscal solution!

Despite the July 2007 Simpler/Better Super changes, many still label superannuation as too complex: my model probably won't change that!

I have set out below features of my New System ("NS") model. I have not necessarily explored all situations or features that this model would need to accommodate. I have not applied any financial modelling to the tax efficiency of my model. Tweaks may be required to facilitate any necessary transitional arrangements. I have not been specific in stating rates of tax to apply. My comments are generally limited to superannuation and not the specifics of dealing with non-superannuation investments.

[Submission continues]

Overview of Superannuation features of a New Retirement Wealth System model

NS 1. Superannuation Concessional Contributions Cap: All future contributions for all eligible persons would be paid under the New System, with contribution caps to be determined.

(a) The concessional contributions cap would be set as the annual equivalent to the prescribed Superannuation Guarantee (SG) rate based on the Maximum Contributions Base (MCB)[1]. In this way, there is:

(i) Scope for those with income below the MCB to concessionally contribute to the same level as a high income earner.

(1) To overcome a conflict with my premise to treat discretionary investments equivalently as a package across all investment types, the superannuation tax package may need a compensatory upwards adjustment.

(ii) No capacity for high income earners to concessionally contribute above the MCB.

(iii) The MCB base is currently indexed, with the corresponding SG amount also increasing as the SG rate progression to 12%. An adjustment to the MCB x SG% rounding basis would be appropriate if that became the cap.

(b) An alternative is to have a nil concessional cap and restrict the concession to strictly the person's SG amount only and hence only be available to those eligible for SG, which overall is administratively clumsy and excludes some participants.

(c) Another alternative is to set a cap that excludes the actual SG contributions up to the MCB, but would suggest that it be a relatively low cap.

(i) This is to not advantage high income earners through a more generous cap.

(ii) However, a low cap would restrict lower income earners from contributing meaningful amounts above their SG.

(d) A further alternative is to have a lifetime cap but generally with limited annual amounts or a limited bring forward rule.

(i) Exemptions could apply for those with interrupted workforce participation – particularly females and long-term unemployed and those not eligible for SG otherwise at any ages.

(ii) The lifetime cap could be based on the [SG% rate x future indexed MCB] expectation over an average working life.

(iii) Legislated increases in the SG rate need to be factored into the equation.

(iv) To recognise an increase in the old-age-pension age, the cap would need an upper calculation date to be adjusted from age 65 as the old-age-pension age increases.

(e) Those who wished to have their superannuation contributions limited to the SG/mandated levels will be free to consume their income and otherwise invest as they see fit: on my model, the tax system as a package would be equivalent across superannuation and a non-superannuation discretionary investments.

(f) An irrevocable opt-out from all future (including voluntary) superannuation contributions could apply for those with account balances above a prescribed (indexed) amount (e.g. as applied for SG in the previous Reasonable Benefit Limit system, and for pre-1 July 2005 defined benefit members only).

(g) Defined benefit funding would remain, adjusted to accommodate the new system.

(h) Contributing splitting remains.

NS 2. Superannuation Non-concessional Contributions Cap: There would not be a need for a non-concessional cap or "bring forward" rules, as such contributions are generally discretionary and on my model would be taxed equivalent to any discretionary investment.

(a) Those superannuation fund's trust deeds or employee agreements that prescribe that there be member's post-tax contributions would generally not be at excessive levels.

(b) Commutation of pre-New System pensions that are re-contributed would be to the New System, forfeiting pre-New System rules for their future accumulation and payment.

NS 3. Pre-New System Benefit component: Current superannuation benefits would be split into a pre-New System component for accumulated capital or the accrued defined benefit (as applicable) and into a New System component.

(a) Those "closer to retirement" obviously will have a larger pre-component, that cohort probably being the most vocal about there not being retrospectivity for validly accumulated/accrued amounts.

---

[1] The Maximum Contributions Base is the maximum limit on any individual employee's earnings base for each quarter of any financial year above which an employer does not to provide the minimum Superannuation Guarantee support.

(b) This component would be applied across all benefit payments.

(c) Instead of being percentage based, it would be a capital amount (cf. the "crystallised segment" as at 1 July 2007), so that there is not an aggregated amount with a proportional draw down (and hence differs to the proportional "pre-July 1983" component abolished from July 2007) that would prolong the pre-New System.

NS 4. Benefits from New System primarily as Income Streams: A significant proportion of benefit payments from the New System would need to be payable as an income stream, with limited lump-sum access.

(a) A prescribed minimum percentage of the capital would be required to be used to purchase the income stream.

(i) The minimum should not favour lump-sum payments:

(1) At least 85% must be used to purchase an income stream.

a. Exceptions would apply for death payments and certain other conditions of release, such as permanent incapacity payments to meet living/housing adjustments, financial hardship and compassionate grounds.

b. Future conditions of release may need to apply for other eventuating needs such as aged or health care.

(2) Alternatively, a modest _one-off_ prescribed amount (annually indexed, if a $5,000 hurdle is met) could be paid as a lump-sum on satisfying a condition of release.

a. There would be no ability to receive a future lump-sum payment after year [t] of first payment. Any future indexed $5,000 increment of the prescribed cap in years [t + 1], [t + 2] etc. would not be available once total lump-sum payments to the cap in year [t] have been received.
(This differs to the manner that the current superannuation payment tax free limit permits [if capital is available] a pre-age 60 tax free payment to catch up to the $5,000 increment/s in the next year/s.)

(ii) Until the New System matures, account values may not support a meaningful income stream.

(1) In the early years of the New System, it's probable that all benefit levels would be below any lump sum cap.

(2) However, the pre-New System component may be higher and together both values could then support an income stream.

a. Incentives may encourage using both components for an income stream rather than take lump-sums from both components.

i. The pre-New System component may source the income stream and the New System (part of) a lump sum.

(b) The Government would need to approve a suite of longevity products.

(i) Development of that suite must address the matter of minimum draw-down rates.

(ii) Any such products could also be available for the pre-New System component.

(iii) Just as many funds now offer a default "MySuper product", there could be a default "income stream product" across both components for those funds.

NS 5. Tax on Concessional Contributions: There would be a multi-tiered tax on concessional contributions at tax rates to be determined.

(a) The marginal tax rate less a rebate (as recommended in the Henry Tax Review) would apply to contributions up to (my proposed) [SG% x MCB] based concessional cap.

(b) Above the concessional cap, there should be a higher tax rate through a lesser or nil rebate.

(i) Provided any tax deductibility of these contributions is reflected, no excess contributions tax need apply, as on my model there is as a package, equivalency of taxation of all discretionary investments.

NS 6. Tax on Non-concessional Contributions: As these are (generally) discretionary, no excess contributions tax need apply, as on my model there is as a package, equivalency of taxation of all discretionary investments.

NS 7. Tax on Earnings: The tax rate for investment earnings in both the accumulation and income stream phases would need to be determined.

(a) There would be a multi-tiered tax on earnings, applicable across all ages.

(i) There would be earnings tax incentives for compulsory superannuation up to the SG/mandated based capital amounts.

(1) An allowance should be made to apply this tax for those superannuation fund's trust deeds or agreements that prescribe there be member's post-tax (non-concessional) contributions.

(ii) Above SG/mandated based capital amounts there should be equivalent tax treatment as a package across all investment types (being less advantageous than SG).

(1) There should be no discretionary investment type advantaged over any other: discretionary superannuation, negatively geared assets and capital gains tax discounts are classic examples of current conflicting advantages; "bank interest" is generally an example of not having an advantage.

(2) A person's risk profile should not be a measure of a tax reward.

a. Higher risk or gearing should not mean lesser tax.

(b) The tax rate on future earnings could generally be consistent across the pre-New System and New System components, as arguably that is prospective only and future earnings are not yet vested in the person.

(i) Capital gains tax exemptions for pre-New System assets will be needed so as to not be retrospective.

NS 8. Pre-New System payments priority over New System payments: When eligible, a person's benefit payments before old-age-pension age would not be permitted from the New System until after any pre-New System component is accessed through a condition of release.

(a) There's a precedent for priority of cashing benefits, with current Superannuation Industry (Supervision) Regulations prescribing when unrestricted non-preserved amounts are a priority ahead of other components.

(b) Conditions of early release amounts would be paid from the pre-New System amounts before any New System amounts.

(c) This is to reduce the incidence of not accessing pre-New System component to retain any favourable features in perpetuity.

(d) This would be met either as a pre-New System lump-sum, or if an income stream has commenced to be paid with all of the eligible pre-New System amounts used as part of the purchase price.

(e) Simultaneous income streams from both components would be permitted, provided all of the then available pre-New System component forms part of the purchase price for that component's income stream.

(i) Any difference in tax rules would apply to the respective income streams.

(f) New income streams from a pre-New System component could be commenced with that component's pre-New System tax rules, retaining its attributes for the income stream.

(g) Certain payments through commutation or reversion of pre-New System pensions continue their previous tax rules.

(i) Typically this would accommodate permanent incapacity, death benefit payments, terminal medical conditions, reversionary pensions.

NS 9. Tax on New System Benefits: All New System benefits would generally be taxable for all persons at all ages - including from age 60 (currently tax free) - in a manner to be determined.

(a) A multi-tier tax regime could apply, with benefits accrued from compulsory SG/mandated amounts being taxed less compared to benefits from discretionary contributions.

(i) The tax on income streams should give an incentive over (albeit limited) lump sums.

(ii) Being compulsorily preserved and also payable as a compulsory income stream, the superannuation tax rates would need to be set at a discount to offset those attributes not applying to non-superannuation investments.

(b) The concepts of *taxable* and *non-taxable* components would remain.

(c) Insurance based benefits from an untaxed source would remain to be taxed.

(d) Untaxed funds and benefits remain, with their tax system commensurately adjusted.

NS 10. Tax on pre-New System component's Benefits: This component would generally have the pre-existing *benefit* tax treatments that applied prior to the start of the New System.

(a) This would not necessarily be consistent/equitable with other investment types.

(b) It would generally be quarantined from future government regressive changes.

(c) Those not having yet met a condition of release retain the pre-New System benefits' tax rules when they do meet a condition.

NS 11. Defined Benefit funds: These remain, with actuarial based certification to address any idiosyncrasies of their funding.

NS 12. SMSFs: These remain, but with no future limited recourse borrowing advantages unless consistent with rules for other (discretionary) gearing tax rules.

NS 13. Preservation ages: In the New System and for the pre-National System component, preservation ages would change to blend with increases in the old-age-pension eligibility age under transition rules that would in any case have applied.

(a) These would apply to politicians and statutory positions.

(b) Conditions of release should be revised to accommodate the physical inability at higher ages to continue in an occupation (e.g. heavy manual labour).

NS 14. Longer workforce participation: The rhetoric of encouraging longer workforce participation must be supported.

(a) An increase in preservation age will not guarantee continued workforce participation or job availability.

(b) There need not be any upper age limit for contributions.

(c) The need to satisfy work tests would be revisited so that at the very least, no work test is required up to the prevailing old-age-pension age.

(d) The matter of how (any) “bring forward” contribution rules (if continued) apply for increased ages would need to be explored.

(e) There needs to be consistency use of age definitions for work tests rules and bring forward rules.

NS 15. Choice of Fund and Transfers between funds: There would be no change to current arrangements, with the pre-New System component retaining its status.

NS 16. Insurance benefits: The matter of providing insurance benefits with increases in preservation and the old age-pension-age would need to be settled.

(a) If the want is to extend workforce participation, parameters for insurance must move with that.

(b) Linkage to the traditional age 65 is anachronistic.

(c) SG based insurance for death cover ceases after age 55 – set at 10 years before the traditional old-age-pension age of 65, taking no account of increased preservation ages or the extended old-age-pension age/s.

NS 17. Government benefits' tests:

(a) New old-age pensioners would have their pre-New System assets treated by the rules applying when/if they are eligible for the old-age pension.

  (i) All account balances would generally be assets for eligibility for the old-age-pension and other Federal Government concessions.

   (1) All investment types would consistently be assessed, with generally no advantage to any asset class.

  (ii) All eligible taxable components of income payments would count for the income test.

  (iii) There would continue to be an “undeducted purchase price” style of exemption.

(b) For pre-existing old-age-pension recipients, their pre-New System assets and income for eligibility for the old-age-pension and other concessions would generally continue to be based on the rules that applied at the start of the New System.

NS 18. Governance, Administration, Investment: These continue as normal.

(a) The *Superannuation Industry (Supervision) Act 1993* and *Corporations Act 2001* with applicable APRA and ASIC supervision remain.

Other commentary

My model of a New System with the prospect of revised contribution caps, an expected increase for some tax rates but a quarantined pre-New System component is outside the square. Consistency in the future (prospective) tax treatment of all wealth creation asset class/investment types would generally provide no tax advantage for any discretionary investment type over another.

With my model, the revised tax treatments are on the table but for only the future contributions, earnings and benefits. The past is quarantined. It'd be great if I could write that “the model provides certainty” for existing accounts that have been validly accumulated under the then prevailing laws and rules.

My model continues the pre-New System component's rules for many decades and does not offer complete fiscal solutions until non-retrospective legacy systems cease. The pre-New System component re-introduces features akin to the "pre-July 1983" component abolished from July 2007, and akin to the crystallised segment established at 1 July 2007. A priority of cashing any pre-New System benefits forces such amounts to be drawn, progressively reducing their past "tax concession"!

Any future discretionary contributions to superannuation above the Superannuation Guarantee/mandated minimum would be voluntary and with full knowledge of its susceptibility to any differing tax and any government tinkering. An individual can then freely choose to invest discretionary monies in or external to superannuation under applicable tax rules, ideally being consistent/equitable as a package across all investment types.

Extension to politicians is conceivable: their contract of employment is only for the electoral term: if re-elected, new conditions can apply for that term, arguably not automatically retaining those of past terms!

There may be flood of setting up of income streams or SMSFs before the change date to retain pre-New System vagaries.

Centrelink already operates systems and procedures for legacy rules. My model is just another. There are other precedents for having variable systems: various pre-July 2007 systems for treatment of superannuation income and assets are one type of example.

Further change might seem a challenge but that is not a valid argument to do nothing to achieve a consistent tax approach for creation pf retirement wealth. In the past each investment type (asset class) has been generally considered in isolation, each arguing for their advantage.

[End of submission]