



TAX FORUM

4-5 October 2011

STATEMENT OF REFORM PRIORITIES

PARTICIPANT NAME AND POSITION

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ORGANISATION

Association of Superannuation Funds of Australia (ASFA)

ASFA is a non-profit, non-political national organisation whose mission is to protect, promote and advance the interests of Australia's superannuation funds, their trustees and their members. Its membership, which includes corporate, public sector, industry and retail superannuation funds, plus self-managed superannuation funds and small APRA funds through its service provider membership, represents over 90% of the 12 million Australians with superannuation.

STATEMENT OF PRIORITIES

1. What are your priority reform directions for the tax and transfer system?

A major priority should be to retain confidence in superannuation and retirement savings through building on both current and announced arrangements. Further change, particularly if it is perceived to be adverse to those saving through superannuation, would have the potential to substantially undermine confidence in superannuation and would reduce voluntary contributions. This would mean that less people in the future would be able to totally or substantially fund their own retirement. The various reductions in the caps on concessional contributions for instance have eroded confidence in superannuation to some extent.

It makes sense for the tax treatment of superannuation to be concessional relative to most other forms of savings. Previous attempts at tax preferred savings outside the superannuation system have not been successful. Such measures are fundamentally flawed in that savings are not required to be preserved or maintained for any period. As well, when there is no requirement to change behaviour to attract a rebate there is little additional saving despite the substantial tax revenue cost from providing concessional tax treatment for the entire stock of savings involved.

The macro economic consequences of a shift in voluntary savings from super to outside super also would be material. These non-super savings because of a lack of preservation and associated liquidity considerations generally would not have the long term investment horizon typically applied by superannuation funds. As a result, shifting tax concessions from super to other forms of saving would lead to less funds being available for longer term investments.

That said, there still are significant gaps in superannuation coverage of the Australian population. Coverage of the self employed is generally voluntary and compulsory contributions do not have to



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be made when an employee earns less than \$450 a month. Extending the coverage of compulsory superannuation to include both the self employed and those (often women) below the earnings threshold in casual and part-time jobs should be a priority.

Increasing the SG to 12% and introducing contributions tax rebate for low income earners

The proposed increase in the rate of the SG is justified on the basis of the improvements in retirement outcomes that it will deliver. Pursuit of this measure also is important to maintain the confidence of Australians in future superannuation arrangements. In this context, survey evidence indicates that both superannuation and the prospective adequacy of retirement incomes have become “top of mind” topics for most Australians.

The Government proposals in regard to an increase in the SG to 12% and the introduction of a tax rebate to increase the superannuation savings of low income earnings have been generally well received by the public. They involve change, but to the benefit of superannuation fund members. In contrast, the Henry Review recommendations on superannuation would have adverse impacts for most fund members (in regard to both take home pay and retirement savings) and would also lead to lower net tax revenues to government for many decades to come.

On the other hand the proposal to increase the SG to 12% would unequivocally assist future retirement incomes while having only a relatively minor impact on take home pay, particularly when compared to the Henry Report recommendations.

The legal incidence of the Superannuation Guarantee falls on employers, but the economic incidence (the actual burden) basically is passed on to employees. The fact that the increase in the SG will be phased in over six years provides assistance to employers in planning to adapt to its introduction. The impact on wages costs in any one year will be small. SG contributions will be phased in very gradually with 0.25 percentage point rises in 2013-14 and 2014-15 and 0.5 per cent increases after that. Additionally, the already sizeable proportion (25 per cent) of employees who already have superannuation contributions greater than nine per cent will ameliorate the effect and short term impacts on employers.

The phasing in will also mean that take home pay will in effect not be reduced in any year. What will occur is that pay rises linked to increased prices and productivity growth will be slightly lower than they would otherwise be. This was the case with the phasing in of the SG from 3% to 9%. It would also be the case for a phasing in of an increase from 9% to 12%.

The Government has also announced that it will be reducing the company tax rate and providing accelerated depreciation provisions for small businesses. Both of these measures will assist employers deal with any cash flow issues that might arise in the short term from an increase in the SG.

In contrast, through requiring contributions to be paid from post-tax income and through the various tax rate changes the Report proposed, adoption of the Henry Report approach generally would lead to reductions in take home pay. In many cases these would be substantial.

Treasury analysis that was released in October 2010 indicates that the aggregate reduction in



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disposable income for the 13 million Australians affected would be \$12 billion. There also would be a \$3 billion per annum cost to government revenue as the loss of contributions tax and the proposed contributions tax rebate would substantially exceed the additional personal tax collected from individuals at the new proposed tax rates.

The Henry Report recommendations would also lead to the considerable new complexity, particularly in regard to transitional arrangements and ongoing record keeping and reporting.

Regulatory and other settings for post-retirement income streams

The background paper for the Tax Forum at page 13 asks whether there are opportunities to improve the rules for superannuation during the drawdown phase.

There are such opportunities given that there currently are regulatory impediments that are making certain post-retirement products providing protection against the financial consequences of longevity more expensive and/or otherwise less attractive than they might be.

With increasing longevity there is an increasing need for such products. Without them there is a very real risk that a substantial proportion of retirees will exhaust their private retirement savings before they die. This will lead to them having a lower standard of living in their older years than they need or want. It will also lead to increased demands on the Age Pension system.

In regard to the specific regulatory impediments, a number of current regulatory provisions restrict product development in the retirement space. Income Ruling IT 2480 and SIS regulation 1.06 (2) basically assume that products are either account-based or a pension without any account balance, and do not deal well with products that have elements of each or have certain benefits that are deferred. This makes the regulatory process more complicated and it also increases the costs of such products.

More specifically, Income Ruling IT 2480 leads to investments supporting a deferred annuity receiving the same tax treatment (taxed at a 15% rate) as assets still in accumulation mode even though it is essentially a retirement income product.

Withdrawal or amendment of the Ruling and amendment of the SIS Regulation would assist both the development and marketing of products providing protection against the financial consequences of longevity. Further legislative amendments might also be required.

As well, product providers must deal separately with the ATO, APRA, ASIC and Centrelink, further complicating the product development process. Greater co-ordination and consistency between the various regulators would be desirable. Also, there are little or no tax or social security incentives for taking a retirement benefit in the form of an income stream as opposed to a lump sum, and no real incentives for purchasing a product which provides protection against the financial consequences of longevity. Going forward there should be consideration of such incentives being provided, particularly when there is a long term trend to increasing longevity. Without incentives individuals may be unwilling to lock up their capital in such products.

Apart from these issues, some of the Henry recommendations, if adopted, would assist in ensuring



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greater supply and take-up of post-retirement products but a number of the recommendations would actually make post-retirement products less attractive.

For instance, it would be of assistance if government policies supported the issuance of long-term securities. This would assist product providers manage the investment risk associated with longevity insurance. While the Henry Report specifically referred to government bonds other investments, such as private sector bonds linked to infrastructure or corporate bonds, could also play roles.

One of the current constraints in relation to the development of products dealing with the financial consequences of longevity is the need to match liabilities stretching over a number of decades with assets held by the provider. Long-term securities are of considerable assistance to providers both in pricing and facilitating longevity products.

It would also be helpful for government to adopt the recommendation that it make available the data needed to create and maintain a longevity index; this would assist product providers in hedging longevity risk. Currently, this data is not readily available and often providers have to make use of partial and/or overseas data.

Less helpful was the Henry recommendation that investment earnings of assets supporting income streams in retirement (currently untaxed) should be taxed at 7.5 per cent p.a. While the Henry Report recommended that the rate of tax on investment earnings during the accumulation phase be reduced, the overall impact would be to remove an incentive to take an income stream within superannuation rather than a lump sum.

The Henry Report also recommended that the Government become a direct provider of immediate and deferred annuity products. This was something the Government has ruled out, for good reason. Governments do not have any particular expertise in such products. The report did not demonstrate any market failure that only direct government provision could remedy. While government could provide such products at a lower cost than private providers, this would only be possible if it were at the cost of taxpayers more generally. Government involvement as a provider would also discourage private providers from becoming involved in immediate and deferred annuity products.

2. How are your proposals financed over the short and longer term?

The tax revenue impact of the increase in the SG and the budgetary cost of the low income earners superannuation contribution rebate have already been built into the Forward Estimates. As well, the net impact on the Budget is even lower when the impact on Age Pension and other expenditures is taken into account. This is because higher private retirement savings interact with the means test for the Age Pension. The impact on the Budget is also reduced by growth in measured wages growth being lower than it would otherwise be, moderating expenditure increases for government programs which are adjusted for growth in average earnings. These effects are demonstrated in a July 2011 paper prepared by David Gruen of the Treasury:
<http://www.treasury.gov.au/contentlist.asp?ContentID=515&classification=54&titl=Speeches>.

In contrast taking up the Henry Report proposals for the tax treatment of superannuation would involve a multi-billion dollar annual cost to tax revenue for many years to come.



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Making the investment earnings of deferred annuities and other like products tax free would have little impact on tax revenues. This is because in the absence of a tax exemption for the investment earnings supporting such products there is no takeup of such products. Instead retirees take out account based retirement income streams with no longevity protection but which still have tax free investment earnings. The Age Pension bill will also be higher in the absence of retirement income products offering protection against the financial consequences of longevity.

LIST OF ATTACHMENTS

May 2011 document "Spotlight on Henry": <http://www.superannuation.asn.au/Reports/default.aspx>