**Submission on the Exposure Draft of *Treasury Laws Amendment (Reducing Pressure on Housing Affordability) Bill 2017***

From: SA Superannuants

Author: Dr Ray Hickman, Research and Information Officer

**Lifting constraints on access to the superannuation system for all people aged over 65**

SA Superannuants (the Association) is an organisation representing the interests of members of the South Australian State Pension Scheme. This scheme pays untaxed-source defined benefit pensions to about 15,000 former employees of the South Australian Public Sector. About 1500 of these people are financial members of the Association. The Commonwealth government also pays untaxed-source pensions to most of its civilian and military superannuants. Untaxed-source pensions are taxed as ordinary income with a 10% tax offset applying after age 60. These pensions also attract the medicare levy of 2% and any additional, taxable income that a pension recipient has is taxed at the marginal rate for the combined income.

The proposals set out in the exposure draft of the *Treasury Laws Amendment (Reducing Pressure on Housing Affordability) Bill 2017* (the Bill) to use the superannuation system to assist with the current housing affordability problem are of interest to the Association. Recipients of untaxed-source pensions are just as likely to use the house down-sizing strategy of putting net proceeds into the superannuation system as other people of similar means receiving taxed-source (non-taxable) pensions. But, in addition, the Association sees the possibility of making the superannuation system work better for everyone and at no cost to the government in either reduced tax revenue or increased age pension outlays.

The Bill will, if implemented, adjust some long-standing constraints on the movement of money into and out of the superannuation system. Thus:

1. The Bill’s Schedule 1 First home super saver scheme will allow money to be removed from the system before the preservation age is reached, without a tax penalty and for a use other than the provision of retirement income to supplement or replace the age pension. and
2. The Bill’s Schedule 2 Contributing the proceeds of down-sizing to superannuation will remove the work test for contributions connected with house down-sizing for people aged over 65.

The Association believes that the superannuation system has developed to a stage where the work test, if it needs to continue at all, need only apply to concessional contributions. We are therefore seeking adjustment of the Government’s proposal to lift the work test for contributions made up of the net proceeds of house down-sizing to include any non-concessional contributions. We suggest that the final version of the enabling legislation have a Schedule 3 which will allow every Superannuation fund to make its own decision on whether or not to accept contributions from people aged over 65 without those people having to satisfy the work test. A fund doing so would have to ensure that the following tax arrangements applied to the contributions and the earnings.

1. No tax deduction would be allowed for the contributions and no contributions tax would be payable on them.
2. Earnings of the contributions would be taxable in the fund no matter whether the money has been paid into an accumulation account or an account backing an income stream.

To maintain the integrity of the superannuation system these contributions should be subject to an annual limit and count towards contribution caps already in place.

This set of arrangements is aimed at assisting people of modest means to get a better return on their savings without this being achieved by paying less tax on those savings. The Association believes that the arrangements can only be a winner for the government. The individuals who chose to make use of the arrangements will have to take into account the greater short-term risk that is associated with saving through the superannuation system as compared to bank accounts. The incentive for them to do so is the larger return that superannuation funds are certain to provide over the medium to long term.

It has been put to the Association that people wanting a larger return on their savings can purchase shares and/or invest in managed funds. Our response to this is that many older people have had little experience in making share purchases or with managed funds and see these methods of saving as unfamiliar and risky. Superannuation funds, by comparison, are familiar savings vehicles which would be much preferred. Indeed, if investing in shares or managed funds was a viable option for most retirees it would not be necessary for the Government to allow the proceeds of house downsizing to be placed in the superannuation system.

It has also been put to the Association that superannuation funds might not be interested in catering for contributions of the type and size that we have in mind. Our response to this is that each fund should be free to make this decision if it wishes.

**Taxation implications**

There is no tax incentive for the making of contributions in what we are proposing and this raises the question – **if there is no tax incentive for investing in superannuation why would anyone want to do it?** The answer is – **investing in superannuation will, in most years, provide a better return to the investor than he/she would get from a term deposit account.**

**If superannuation contributions, made as we are suggesting, are allowed for fully retired people the Government will be creating conditions that allow people with the desire to manage their savings more efficiently to do just that.**

The calculations set out below demonstrate how superannuation accounts could work to the advantage of fully retired people with little risk of reducing taxation revenue or increasing Centrelink outlays. A bank account interest rate of 3% is compared with a before-tax, and after expenses, return of 6% from a superannuation account. This is likely to be a conservative comparison. The SuperRatings website recently carried this statement from its Chairman.

At a time when inflation hovers below 2% per annum, Australian super funds continue to far exceed expectations, with accrued earnings of well over 10% since the end of the GFC. Over the last 5 years alone, funds have averaged 10% earnings every year, more than erasing the pain of the GFC and putting retirees in a significantly improved position than they could ever have hoped for.

.

**When contributions are made to an accumulation account**

**Example 1:** the fully retired person is currently not paying any tax and has $20,000 in a bank account earning 3% p.a. This delivers $600 interest to the person and no tax to the government. If the $20,000 is transferred to the superannuation system it is likely to deliver a 6% return before tax. So the person’s superannuation account balance will increase by $1,200 before tax. The superannuation fund will pay as much as $180 of this in tax to the government and the person’s account balance will increase by at least $1,020 i.e. by at least $420 more than the increase that would have occurred had the money stayed in the bank account.

**Summary:** the government has gained up to $180 in tax revenue and the person has gained at least $420.

**Example 2:** the fully retired person is currently paying tax at the rate of 19% and has $20,000 in a bank account earning 3% p.a. This delivers $600 interest to the person who then pays $114 in tax leaving $486 to increase the bank account balance, If the $20,000 is transferred to the superannuation system it is likely to deliver a 6% return before tax. So the person’s superannuation account balance will increase by $1,200 before tax. The superannuation fund will pay as much as $180 of this in tax to the government and the person’s account balance will increase by at least $1,020 i.e. by at least $534 more than the increase that would have occurred had the money stayed in the bank account.

**Summary:** the government has gained up to $66 ($180-$114) in tax revenue and the person has gained at least $534.

**Example 3:** the fully retired person is currently paying tax at the rate of 32.5%, plus the medicare levy of 2%, and has $20,000 in a bank account earning 3% p.a. This delivers $600 interest to the person who then pays $206 in tax and medicare levy leaving $394 to increase the bank account balance, If the $20,000 is transferred to the superannuation system it is likely to deliver a 6% return before tax. So the person’s superannuation account balance will increase by $1,200 before tax. The superannuation fund will pay as much as $180 of this in tax to the government and the person’s account balance will increase by at least $1,020 i.e. by at least $626 more than the increase that would have occurred had the money stayed in the bank account.

**Summary:** the government has now lost $26 ($206 - $180) in tax revenue and the person has gained at least $626.

This type of superannuation account will only lead to reduced government tax revenue if nearly all the fully retired people opting to move money from bank accounts into the superannuation system are taxpayers paying tax at 32.5% plus the medicare levy (Example 3). This is very unlikely because most fully retired people are not tax-payers at all and the advantage for non-taxpayers (Example 1) is a substantial fraction of the advantage for people paying tax at 32.5% plus the medicare levy. If taxpayers find this type of superannuation account attractive so will non-taxpayers.

**Impact on age pension outlays:** where this strategy produces superannuation account balances larger than the original bank account balances, and the person is getting an age pension payment, that age pension payment is going to be reduced. The account balance increases will increase the deemed income used in the age pension income test and increase the value of assets used in the age pension asset test. This is another factor that can only work in the Government’s favour.

**When contributions are made to an income stream account.**

We propose that where a contribution made by a fully retired person aged over 65 goes into an income stream account the income stream provider should pay earnings tax on the fraction of the earnings that is attributed to the contribution. This would see the calculations set out above being the same regardless of whether contributions are made to an accumulation account or an income stream account.The Association envisages that where a fully retired person has an existing income stream account established after 1 January 2015 he/she can increase the account balance by making a contribution and taking the additional amount of annual pension that the rules governing draw-down amounts requires. Alternatively a person could opt to pay his/her contributions into a separate accumulation account which might later be converted to an income stream account. We accept that it might not be feasible for people to contribute to income stream accounts that commenced prior to 1 January 2015 because of the way those income streams are assessed under the age pension income test.

There will be some people who look at the gains to be made from the arrangement set out above and say they are gains too small to bother with. It is this attitude that explains why the superannuation system has become a problem for government.

The Association urges the Government to give the arrangement we have proposed a go to see if fully retired people are prepared to take a bit of a risk with a system that could make them better off and without this being achieved through reduced tax revenue for the government and/or increased Centrelink payments.

If you require more information about our proposal please contact me.

Yours sincerely,

Dr Ray Hickman, Research and Information Officer

1st August, 2017