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AFTS Secretariat
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Langton Crescent
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Dear Mr Henry

Australia's future tax system

The Financial Planning Association of Australia (FPA)[1] welcomes the opportunity to provide input to the Government's comprehensive review of Australia's taxation system.

The attached submission highlights key issues for consideration in the development of Australia's future tax system. The FPA and its members believe that simplifications and improvements to the tax system would greatly enhance retirement savings for Australians and therefore reduce reliance on the Government's social security system. We have focused on:

1. Superannuation;
2. Government benefits and workforce participation;
3. Encouraging a savings culture;
4. Insurance; and
5. Facilitating a strong and internationally competitive tax regime.

The FPA believes the recommendations made in the following submission would assist in achieving the Government's objectives of the Review to provide the certainty and security for pensioners, remove some of the challenging disincentives to workforce participation, enhance Australia's productivity and prosperity in an increasingly competitive global environment, and simplify and harmonise the complexities within the tax system.

The FPA would welcome the opportunity to discuss these issues with the Tax Review Panel.

If you would like further information on the issues raised in this submission, please contact Gerard Fitzpatrick, General Manager, Policy and Government Relations (02 9220 4505; gerard.fitzpatrick@fpa.asn.au).

Yours faithfully

Jo-Anne Bloch
Chief Executive Officer

[1] The FPA is the peak professional organisation for the financial planning sector in Australia. With approximately 12,000 members organised through a network of 31 Chapters across Australia, the FPA represents qualified financial planners who manage the financial affairs of over five million Australians with a collective investment value of more than $630 billion.

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Submission to the Tax Review Panel

Financial Planning Association of Australia

October 2008

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Introduction

The Financial Planning Association of Australia (FPA) is the peak professional organisation for the financial planning sector in Australia. With approximately 12,000 members organised through a network of 31 Chapters across Australia, the FPA represents qualified financial planners who manage the financial affairs of over five million Australians with a collective investment value of more than $630 billion.

The purpose of Australia's future tax system is to collect revenue from residents and businesses to build a pool of resources to help fund essential services for all Australians, particularly those in most need of assistance. Australia's future tax system should be simple, efficient and equitable, which are fundamental principles the FPA believes must underpin our nation's tax system.

The FPA also believes it is vital that the tax system is integrated with, consistent with, and supports other Government initiatives and policies. In particular, the Government's approach to ensuring retirement adequacy for all Australians, including the welcomed initiative to improve the pension system and further develop policies to help people save for a self-funded retirement.

As life expectancy rates continue to increase, along with the rising cost of living, retirement income streams need to sustain people for much longer and the actual amounts need to be higher. The number of Australians over 65 years of age has increased by 67 per cent in the last 20 years[2]. The FPA understands there are significant issues with the age pension system which are vital to ensure that more Australians live in retirement comfortably. However, we believe there are also a number of wide ranging issues related more broadly to the adequacy of retirement income which warrant consideration.

Retirement income primarily comes from three main sources:

1. Superannuation – a positive Government initiative to incentivise Australians to save for a self-funded retirement.
2. Other personal savings – Australia needs to move to a 'savings culture'.
3. Government age pension – a vital Government safety net for those Australians in need of financial support in retirement.

Recent research shows the 'retirement savings gap' was as high as $823 billion in 2003-04[3]. Given that many people are failing to provide adequately for retirement income now, the implication is that without changed behaviour, the retirement savings gap may grow. In fact, projections indicate that the average worker will receive close to a third of their retirement income from the pension[4].

However, Australians are less confident when it comes to complex issues like investing and ensuring enough money for retirement: 86 per cent of Australians do not believe that the age pension will be sufficient for retirement, and 73 per cent say employer funded superannuation will not meet their retirement needs[5].

This research indicates that many Australians will rely on the age pension, in whole or in part, to fund their retirement. It highlights that investing for quality of life and health beyond retirement is a new essential in the 21st century.

The FPA believes improving Government policy to encourage Australians to save through retirement, and to smooth the transition between work, self-funded retirement and the age pension, would greatly enhance retirement adequacy and reduce reliance on social security benefits.

Financial planners play a significant role in assisting Australians to prepare for retirement, and the FPA continues to promote the value of professional advice in this regard. A key service of our members is explaining the various complexities of the tax and pension systems to their

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[2] Rhonda Parker, Aged Care Commissioner, *Successful Ageing*, Retirement Village Association Annual Conference, November 2007

[3] Investment and Financial Services Association, *Australia's National Savings Revisited: Where do we stand now,* 2007

[4] AMP Superannuation Adequacy Index, 2008

[5] *Financial literacy: Australians understanding money*, September 2007

clients from an education perspective. We believe that the absence of affordable advice, and the fact that many Australians do not understand the net benefits of advice, means that fewer people are prepared to fund their own retirement.

However, retirement adequacy is not just about the 'pot of money'. Access to services and assistance which encourage and support self-funded retirees, as well as those most in need, are vital. Similarly, encouraging a 'savings culture' must look beyond savings initiatives. Consideration should also be given to financial literacy, access to affordable financial advice, debt management, budgeting and addressing the underinsurance 'protection gap'.

The FPA also believes the Government's push to develop Australia as a financial services hub must be underpinned by an internationally competitive tax system that serves the needs of both individuals and businesses.

In responding to the Tax Review Panel's *Architecture of Australia's tax and transfer system* paper, the FPA has focused on measures which we believe will assist families, now and in the future, to become more financially independent, backed by a strong, stable and internationally competitive economy.

In our submission we address retirement adequacy, the value of advice, and the barriers to preparing for retirement. These are issues that we believe are critical to ensuring that more people are able to fund their own retirement so that the pension becomes a more effective safety net for those in our community who really need it.

The FPA believes adopting the following recommendations would effectively deliver good social outcomes by simplifying Australia's future tax system and improving the long-term financial security of Australians.

Summary of recommendations

Superannuation

1. The FPA recommends further consultation and discussion to determine the optimal level and mechanism for achieving an increase in the Superannuation Guarantee above the current 9 per cent.
2. The FPA recommends Government superannuation co-contribution scheme:
   a) increase the Government contribution above $1,500;
   b) increase the income threshold for access to the Government co-contribution; and
   c) extend the co-contribution scheme to people who are not working by removing work requirement or introducing a family income threshold.
3. The FPA recommends the Government simplify the small business Capital Gains Tax (CGT) concession rules by removing the cap to allow small business owners to contribute to superannuation following the sale of their business assets without penalty.
4. The FPA recommends the superannuation 10 per cent employment income cut-off threshold be removed so that all personal contributions can be tax deductible up to the relevant cap, irrespective of the individual's employment status.
5. The FPA recommends the Government set the concessional contribution cap for those over 50 years at two times that of the concessional cap for those under 50 years.
6. The FPA recommends the superannuation work test should be removed.
7. The FPA recommends that any income (including capital gains) derived prior to payment of a lump sum benefit on assets which has been held to provide a pension to the deceased, should continue to be exempt from tax on the basis that the final payment relating to the pension has not been paid.

Government benefits and workforce participation

8. The FPA recommends the monetary amounts for the Pension Bonus Scheme are reviewed to reflect current inflation levels. The FPA also recommends the five year cap on the Pension Bonus Scheme be extended and the work test requirements be removed.

9. The FPA recommends individuals who continue to work past retirement age should be eligible to receive a discount on their PAYG income tax; and a payroll tax discount should apply to employers with employees over age 65.
10. The FPA recommends the income test for the Seniors Health Care Card be based on the pension payments less the annual deductible amount.
11. The FPA recommends the assessable income for Government benefits should be calculated only on the superannuation payment received above the tax-free threshold limit for people aged 55 to 59 years.

Encouraging a savings culture

12. The FPA recommends Government incentives to help consumers pay for advice, such as tax rebates and tax deductibility of advice fees. There should be a level playing field for advice fees.
13. The FPA recommends the establishment of a Government incentivised lifetime savings account and the amendment of section 102 of the Income Tax Assessment Act to remove the tax penalty upon parent established child bank accounts.
14. The FPA recommends the establishment of Government incentivised medium-term savings options to help Australians save for children's education and unforeseen medical expenses, for example.

Insurance

15. The FPA suggests extending the requirement to have minimum compulsory life insurance cover beyond the default superannuation fund to all superannuation accounts.
16. The FPA recommends the minimum insurance cover required under the Superannuation Industry Supervision Act be based on a consistent formula - one formula for death cover and one formula for Total and Permanent Disability cover.
17. If the Superannuation Guarantee is increased above 9 per cent, the FPA recommends part of this increase should be used to increase the level of insurance.
18. The FPA recommends the Government provide a tax rebate on insurance premiums for low income earners.
19. The FPA recommends addressing the anomalies and complexities of the tax treatment of insurance.

Facilitating a strong and internationally competitive tax regime

20. The FPA recommends Australia's future tax system should remove many of the unnecessary anti-avoidance tax laws and create a simple, efficient and equitable system for all Australians.
21. The FPA recommends a rationalisation and harmonisation between the Federal, State and Local tax systems and tax rates.
22. The FPA recommends consideration be given to the arrangement for collecting taxes and whether one collecting authority would be appropriate.
23. The FPA recommends Australia improve its imputation system by ensuring that foreign tax credits can flow through to shareholders by being recognised as payments of company tax liabilities, which should be counted in the company's franking credit account.
24. The FPA recommends the tax laws should be amended to allow franking credits to flow through discretionary trusts, without the family trust election principles, provided the trustee has held the shares for the required period.
25. The FPA suggests that further improvements are required to the CGT small business concessions, and recommends disregarding goodwill as an asset for Capital Gains Tax purposes.
26. The FPA recommends the two year cut-off for Self Managed Superannuation Funds absence from Australian residency should be removed.

1. Superannuation

As life expectancy rates continue to increase, retirement income streams need to sustain people for much longer. In Victoria for example, the life expectancy for women is around 83 years and for men 77 years, creating a retirement period of between 12 and 18 years for those retiring at age 65[6]. It is important that the tax system provides support to ensure retirement savings can continue to grow for some time after actual retirement.

The FPA believes improving Government policy to encourage Australians to save through retirement, and to smooth the transition between work, self-funded retirement and the age pension, would greatly enhance retirement income adequacy and reduce reliance on social security benefits.

Government policy should reflect the increasing life expectancy rates and the resulting longer retirement stage of life for Australians. This issue should not just be addressed by a larger amount of funding, but by improving the efficiency of the policies and systems that support retirement income.

The FPA believes the following principles should underpin Australia's future tax system in relation to superannuation:

- Australia's tax system should encourage long-term and medium-term saving.
- Australia's tax system should support longevity in retirement and adequate retirement incomes for all Australians.
- Australia's tax system should provide equity and simplicity in retirement.

1.1 Superannuation Guarantee

A couple retiring today require $49,502 per annum to live a 'comfortable' lifestyle[7]. In order to generate this level of annual income, a lump sum at retirement of approximately $600,000 or more is required. It is a significant concern that the average superannuation balance for those in the 60-64 age bracket is only $202,600[8].

Given that nearly 11,650,000 Australians currently earn the average wage of approximately $51,000 per year or lower[9], projections would show that these people would be unable to accrue adequate levels of superannuation based on the 9 per cent Superannuation Guarantee, even given a lifetime of saving. Therefore, the ability for people to self-fund their retirement would be limited and many Australians would need to rely on the age pension in the future.

The FPA believes the Superannuation Guarantee is insufficient and recommends the contribution level be increased above the current 9 per cent. FPA members suggest an increase to between 12 and 15 per cent. Contributions for a higher level of Superannuation Guarantee could be delivered through one of the following options:

a) increase the Superannuation Guarantee in total; or

b) a soft compulsion mechanism to encourage contributions from employees, employers and Government. The distribution of contributions could reflect need and affordability as well as consider practical implementation issues.

The FPA recognises that this is a significant change and potential cost burden particularly for employers. We would suggest that any changes would need to be brought in over a period of time and staged so as to minimise the impact on the economy.

The FPA would encourage and welcome further consultation and discussion to determine the optimal level and soft compulsion mechanism for achieving an increase in the Superannuation Guarantee.

[6] www.betterhealth.vic.gov.au
[7] Westpac ASFA Retirement Standard, February 2008
[8] Rice Warner's Superannuation Market Projections
[9] Australian Bureau of Statistics, 2006 Census

1.2 Government superannuation co-contribution scheme

The FPA recommends consumers should be encouraged to contribute to superannuation voluntarily wherever possible. To incentivise Australians to save for retirement, the FPA recommends the following changes to the Government co-contribution scheme:

a) increase the Government contribution above $1,500; and

b) increase the income threshold for access to the Government co-contribution.

The FPA recognises that this benefit focuses on those currently working. We recommend the removal of the requirement to work to extend the co-contribution scheme to people who are not working such as stay at home mothers (possibly limited to those receiving family tax benefit A), carers, and workers compensation injured workers. An alternative approach would be to introduce a family income threshold. This would take into account a non-working spouse and promote greater equity and participation in the superannuation system.

The FPA suggests the fiscal impact of this broadening of the co-contribution scheme would be adequately covered by the resulting future savings on age pension expenditure and should not be funded by an increase in other superannuation taxes.

1.3 Access to superannuation for the self-employed

With more than 1.88 million small businesses in Australia employing 3.6 million people and with a total capitalised worth of $4.3 trillion, four times that of the Australian stock exchange, small business is a very important sector of the Australian economy.

However, self-employed Australians still have difficulty in getting the full benefit of the superannuation system because they often cannot make regular contributions over a lifetime and can be faced with a need to make large lumpy contributions late in life. This is because so much of their savings is tied up in their businesses.

It is quite common for small business owners to reinvest their income back into their business as the major family asset. Many self-employed and small business owners assume they'll simply sell their business when it's time to retire and contribute the proceeds to superannuation.

However, the rules for small businesses to claim the small business Capital Gains Tax (CGT) concessions, which qualify them to rollover lump sum amounts into superannuation, are very complex especially where the business is owned via one or more companies and/or trusts.

Such rollovers are now considered by the regulator as contributions, making amounts up to $1,045,000 subject to the superannuation contribution restrictions and work test requirements. This discriminates against older Australians who have worked hard to build a nest egg via their business. This is a relatively small amount and as such treating the payment as a rollover as previously allowed should not result in a hugely significant budgetary impact.

Small business owners are also faced with stringent notification requirements in order to claim the CGT cap. Failure to meet these requirements makes them ineligible to use the CGT cap and therefore likely to breach the superannuation non-concessional contributions cap.

The FPA recommends the Government simplify these rules by removing the cap to allow small business owners to contribute to superannuation following the sale of their business assets without penalty.

1.4 Deductible personal superannuation contributions

The current 10 per cent employment income cut-off threshold, which determines an individual's eligibility to claim a personal tax deduction in relation to superannuation contributions made in any given year is complex, arbitrary and difficult to calculate. Often, the 10 per cent cap cannot be accurately worked out for weeks after the end of a financial year. Many may simply not work or claim a deduction for fear that an extra PAYG payment will result in a failure of the 10 per cent cap.

In addition, for some employees the ability to salary sacrifice is not available. It is inequitable that one employee can take advantage of the tax efficiency of a salary sacrifice but another cannot simply because their employer will not allow it. The ability to claim personal superannuation contributions as a tax deduction is an alternative means of contributing to retirement savings.

The FPA recommends the 10 per cent test be removed so that all personal contributions can be tax deductible, up to the concessional contributions cap, irrespective of the individual's employment status. This would result in a simplification of the system, would remove current anomalies, and encourage more Australians to voluntarily increase their superannuation savings. This would reduce reliance on the social security system.

1.5 Superannuation concessional contributions cap

Government policy should encourage Australians to contribute to their superannuation and, where possible, fund their own retirement. The pending reduction of the superannuation concessional contribution cap from $100,000 to $50,000 for people over 50 years of age in 2012 creates additional unnecessary barriers for Australians to save for their retirement. In addition, the five year transition does not allow sufficient time for those aged 45 plus to adapt their transition to retirement plans to cater for these changes and ensure their financial security in retirement.

The FPA recommends the Government set the concessional contribution cap for those over 50 years at two times that of the concessional cap for those under 50 years. The lead up to retirement (such as the last 10 years of full-time work) is a critical period for retirement preparedness, employing sound transition to retirement strategies and growing one's retirement savings. These measures would encourage individuals to contribute to their superannuation and would, in the long-term, reduce the reliance on the age pension and the social welfare system.

1.6 Superannuation Work Test

The superannuation work test requires individuals between the ages of 65 and 74 to work 40 hours in 30 consecutive days during the financial year, to be eligible to contribute to superannuation. Those over 75 years are not permitted to make superannuation contributions. The FPA recommends the superannuation work test should be removed.

Those who are over 65 and have not yet managed to save enough for their retirement, as well as those who are in the process of organising their retirement income streams into superannuation, have been particularly disadvantaged by the work test. Removing the work test would greatly assist in remedying the situation for each of these categories of people.

In the majority of situations where a large contribution is required as part of a retirement strategy, the person involved will not be in a position to meet the work test. This will generally hold true for people selling small businesses, rural families selling their farms, people receiving disability payouts, people receiving inheritances (especially women), and working people over 65 who suddenly become ill. If significant additional workforce productivity is unlikely to be encouraged through the existence of a work test, and it increasingly discriminates against certain classes of people, then its value must be called into question.

The removal of the work test would provide an opportunity for more Australians to achieve self-funding of their retirement goals whilst minimising their reliance on Government social security. Having regard to the age of the people affected and the limited amounts involved, it is suggested that there is little potential for this relaxation to be used as a post-retirement tax avoidance strategy.

1.7 Capital Gains Tax (CGT) on death benefits in pension phase

The FPA believes that with respect to superannuation in the pension phase, death should not trigger CGT, regardless of the dependency status of the beneficiary.

Currently, where a superannuation fund trust deed does not provide for a reversionary pension and the sole pensioner member of the fund dies, the Australian Tax Office (ATO)

asserts that the tax exemption on earnings is not available after the member's death on the basis that there were then no current pension liabilities[10].

The tax exemption on earnings will continue if a member who was in receipt of a pension dies and the trustee applies the death benefit by way of a reversionary pension or applies the balance of the deceased's super to commence a new pension in favour of a tax dependant (which may have a different income level)[11].

However, where the death benefit is applied by way of a lump sum benefit that is ultimately paid after the death of a member, the ATO says that the tax exemption on earnings will cease. If this is the case it means that upon sale of the assets to facilitate the lump sum payment, any realised capital gains are taxed. The realised gains are calculated using the original cost base of the asset when the fund first acquired it which could extend back to the accumulation phase.

In a typical arrangement, the fund trustee will have the capacity to choose (sometimes after having consulted the beneficiary to gauge his or her preference) between payment of a lump sum benefit or to continue to apply the account proceeds towards the payment of a pension. If the decision is that the benefit will be paid (in part or wholly) in the form of a lump sum, the FPA believes the tax treatment of the fund should be the same as if the decision were to make the payment wholly as a pension.

Often such a decision will be driven by the financial security of those who may receive the lump sum benefit. It is quite anomalous that those who may 'need' a lump sum to pay off debt will bear taxation whilst those who do not will avoid it by continuity of the pension.

From 1 July 2007, trustees were also prevented from continuing a pension in favour of adult children or applying the balance of the deceased's account to commence a new pension for adult children. In addition if a member dies in pension phase and the beneficiary is a dependant child at the date of death, any pension paid to them must cease at age 25, unless the child is permanently disabled. Any remaining balance must be paid to the child as a tax-free lump sum.

The FPA recommends that any income (including capital gains) derived prior to payment of a lump sum benefit on assets which have been held to provide a pension to the deceased, should continue to be exempt from tax on the basis that the final payment relating to the pension has not been paid.

If there are concerns about the delays in finalising some lump sum death benefits and the beneficiaries having the benefit of the tax exemption during this period, the FPA would support a two year grace period after which the tax exemption on earnings would cease.

1.8 Use of terminology

The FPA is concerned by the statement in the *Architecture of Australia's tax and transfer system* paper 'For concessional superannuation, the ability to invest out of pre-tax income produces a negative EMTR' (page 251). This section of the paper also refers to the 15 per cent tax rate on superannuation contributions as a 'negative tax'. This implies that it may be appropriate to address this 'negative' tax rate, which would mean an increase in tax on superannuation. The FPA believes it is wrong to suggest that superannuation gets the benefit of a negative tax rate, and that an increase in superannuation taxes would have a significant impact on Australians' desire to contribute to superannuation and their ability to self-fund their retirement. This would put additional pressure on the pension system.

The calculation showing the negative tax rate in the paper appears to be based on the assumption that any tax rate lower than the Marginal Tax Rate (MTR) that would otherwise be imposed amounts to a negative tax rate. We would challenge this assumption. If one is taxed at 15 per cent, as in the case of superannuation, rather than the MTR of 46.5 per cent, this represents a lower tax rate, not a negative tax rate. The tax rate on superannuation contributions is 15 per cent; the tax rate on superannuation earnings is 15 per cent in the accumulation phase or 0 per cent in the pension phase. Hence the tax rate on superannuation benefits received after 60 can lie between 15 per cent and 0 per cent and is not negative.

[10] Australian Tax Office ID 2004/688
[11] Australian Tax Office ID 2004/688

The superannuation system was put in place as a vital savings mechanism to incentivise Australians to fund their own retirement and alleviate pressure on the social security system. Therefore, the FPA would caution the use of any calculations relating to this system as a 'negative tax' resulting in an 'investment bonus'.

2. Government benefits and workforce participation

Government benefits provide assistance in retirement which extends beyond the age pension. The age pension provides a vital safety net for those Australians who do not have adequate savings, including superannuation, to support their financial needs in retirement. However, Government benefits, such as the Seniors Health Care Card, provide a vital service which enables self-funded retirees to remain self-funded for as long as possible, alleviating the reliance on the age pension.

The FPA believes the following principles should underpin Australia's future tax system in relation to Government benefits for retirees:

- Australia's tax system should provide incentives for continuous saving to smooth the transition between work, self-funded retirement income and Government benefits.
- Australia's tax system should provide incentives for continuous saving and working.

2.1 Incentives to defer the age pension

To improve the transition from a superannuation income to the age pension, the FPA recommends the Government should improve the financial incentives offered through the Pension Bonus Scheme for people to continue working and in so doing, reduce the reliance on the age pension at younger ages.

Currently the Pension Bonus Scheme allows people of pension age to defer receiving their age pension entitlements for a maximum of five years. The longer you defer receiving the pension the greater the amount. However you need to register between the ages of 65 and 75. Once you are over 75 you are not entitled to this option. In addition, a work test needs to be satisfied. The FPA supports the current system by which the age pension can be deferred but suggests it could be used more extensively aligned with appropriate levels of private saving.

The FPA recommends the monetary amounts for the Pension Bonus Scheme need to be reviewed to ensure they reflect current inflation levels. The FPA also recommends the five year cap on the Pension Bonus Scheme be extended and the work test requirements be removed.

Adopting these recommendations has the potential to smooth the transition from superannuation income to the age pension while removing existing obstacles to continuing self-funded retirement savings. This would reduce reliance on social security.

2.2 Incentives to encourage workforce participation

To address the demographic, social and economic challenges of an ageing population the FPA believes that the Government must introduce measures to encourage workforce participation. The following measures should be considered:

- Individuals who continue to work past Age or DVA Pension age should be eligible to receive a discount on their PAYG income tax.
- A payroll tax discount should apply to employers with employees over age 65.

The public policy benefits of these proposals include broadening and sustainability of the tax base and a reduction in the fiscal burden through less reliance on the age pension. In addition, it would promote greater diversity in the Australian workforce and would contribute to the health and wellbeing of older Australians. Recent studies have shown that continued participation in the workforce can assist in improving mental and physical health, and as a consequence alleviate the pressure on the public health system.

2.3 Seniors Health Care Card

Ageing increases the risk of some diseases and health conditions[12] escalating medical costs. This is a common experience in retirement. The main purpose of the Seniors Health Care Card (SHCC) is to provide access to Pharmaceutical Benefits Scheme prescription medicines and certain Medicare services at a cheaper rate. This vital Government benefit which assists retirees to fund much needed medical expenses, allows superannuation benefits and personal savings to sustain self-funded retirement for a longer period of time.

Effective 1 July 2009, the income test for the Seniors Health Care Card will change to include the adjusted taxable income from superannuation pension payments. Previously the income test for the SHCC was based on pension payments less the annual deductible amount.

The change to the SHCC income test greatly restricts access to this vital Government service for a large percentage of self-funded retirees. The net result of this change will be self-funded retirees moving to the age pension sooner, as their savings will deplete at a much faster rate due to the increase in medical expenses.

The FPA recommends reverting to the previous system for the SHCC income test based on the pension payment less the annual deductible amount.

2.4 Calculating assessable income for Government benefits

Those Australians who choose (or need) to withdraw their superannuation benefit as a lump sum when aged between 55 and 59, incur a 16.5 per cent direct tax on the payment for amounts above $145,000. However, although direct tax is not payable up until the $145,000 limit for taxable component of superannuation, this amount is included in assessable income. This affects eligibility for the co-contribution and family tax benefits as both these entitlements are based on assessable income.

Under these circumstances it is common for no benefit to be received as a result of the assessable income calculation, which can significantly impact the overall retirement income of Australians.

The FPA recommends the assessable income for Government benefits should be calculated only on the superannuation payment received above the tax-free threshold limit for people aged 55 to 59 years.

3. Encouraging a savings culture

The FPA believes the following principles should underpin Australia's future tax system in relation to Australians' financial independence:

- Australia's tax system should encourage a savings culture.
- Australia's tax system should assist consumers to pay for financial advice.

3.1 The individual and societal benefits of financial advice

Currently, "approximately 8 million Australians or 53 per cent of the adult population have been assessed as having low levels of knowledge and skills required to effectively manage and respond to the mathematical demands of diverse situations"[13]; and 44 per cent of households on incomes of less than $50,000 per annum do not have the skills to make sound financial decisions[14].

Financial advice from a qualified professional can help Australians understand financial matters, to improve retirement savings. Recent research found advice from a qualified financial planning professional unlocked $1.7 million in collective financial value for eight Australians. In most cases, the financial advice led to immediate savings. Financial education was the component of financial advice most valued by consumers. Other valued consumer benefits include effective cash and debt management and reduced lifestyle instability[15].

[12] www.babyboomerslifechange.com.au
[13] Organisation for Economic Cooperation and Development (OECD), published by the Australian Bureau of Statistics
[14] The Smith Family
[15] FPA Value of Advice Research, by Rice Warner Actuaries, February 2008

The research also identified clear societal benefits of advice:

- Reduced debt - increases disposable income for more productive purposes.
- Higher rates of return on investments over long periods - building wealth.
- Insurance protection - prevents people from relying on welfare.
- Higher levels of savings – reduces reliance on government benefits during and after retirement.
- A financially literate and conscientious society that would make better long-term decisions.

Government policies which facilitate consumer access to affordable financial advice, particularly on insurance, retirement income and superannuation, would improve Australians' financial independence and reduce reliance on Government social security benefits in the long-term.

3.2 Incentives to help consumers pay for financial advice

Government incentives to help consumers pay for advice, such as tax rebates and tax deductibility of advice fees would help consumers make sound and informed financial decisions, improve retirement income adequacy and reduce reliance on the age pension. Access to such incentives should be capped to ensure they assist those Australians who are in most need of assistance.

3.3 Consistency of tax treatment for financial advice

Consumers are paying for personal financial advice in varying ways that result in different taxation treatments for no apparent public benefit. This variety of treatment appears to be contrary to Government policy as reflected in the Australian Tax Office Taxpayers Charter that aims to treat taxpayers consistently.

Currently, a fee for service arrangement for preparation of an initial financial plan recommending investments is not tax deductible under section 8-1 of the Income Tax Assessment Act 1997. This is because the ATO views this not be an expense incurred in producing assessable income.

However when the financial adviser arranges for the issue of financial products as a result of providing this initial financial plan the adviser could opt to be paid by commissions from the product issuer rather than charging a fee for service to the client. This results in a tax anomaly.

The availability of a tax deduction or tax rebate for the payment of fees for advice would create a level playing field between commissions and fees for advice and provide the member with choice as well as greater transparency regarding fees. The advice given by accountants is of a similar nature to that of financial planners. Initial advice provided by accountants is tax deductible while the situation for financial planning advice is confused.

Allowing initial fees to be tax deductible would greatly assist consumers' access to affordable financial advice and improve the competitive neutrality of the financial advice profession. While this would involve some additional costs to revenue, these costs would be significantly outweighed by the longer-term benefits.

3.4 Encouraging lifetime savings

The FPA recommends the establishment of a Government incentivised lifetime savings account. This program could involve a tax effective account set up by a parent at the birth of a child, with a one-off Government bonus contribution for each child. Parents, extended family members, and friends should be allowed to contribute to the account until such time as the funds are transferred either into a medium-term savings option, such as the First Home Savings Account, or education account, or the child's superannuation account upon commencement of full-time work.

Akin to similar accounts in other countries, the lifetime savings account must be tax effective. No tax should be incurred by those contributing to the account or by the parents for interest earned on the funds. To ensure effective operation of the system, the lifetime savings account may require caps.

The FPA suggests the establishment of a lifetime savings account would encourage inter-generational and low income earner savings and play a significant role in shifting Australia from a culture of consumption to a culture of savings. To enable the introduction of lifetime savings accounts, Section 102 of the Income Tax Assessment Act should to be amended as it presently imposes a tax penalty upon parent established child bank accounts.

3.5 Medium-term savings options

Research has shown that the core issues identified as causing financial difficulty for Australians involve consumer behaviour issues such as 'unhealthy' ways of thinking about finances including 'living for today', 'financial disengagement' and 'aspirational' spending[16].

It is also a concern that 11 per cent of baby boomers have not given much thought to retirement and have made no preparations, 24 per cent have given some thought to it but made very little preparations and 44 per cent have made some but 'not enough' preparations[17].

The FPA recommends the establishment of medium-term savings options would help facilitate change in the savings behaviour of Australians, as well as assist consumers to pay for essential lump sum expenses. Accounts for children's education and unforeseen medical expenses are suggested. The medium-term savings options could operate in a similar way to the First Home Savers Account, with Government co-contributions, and any funds not used for the stated purpose rolled into superannuation. However, there should be easy access to funds for important payments.

While the First Home Savings Account is a welcome initiative, its focus is on home ownership. Medium-term saving which can be accessed in times of need, would provide an alternative to accessing longer-term savings such as applying under the hardship provisions to access superannuation.

4. Insurance

The FPA believes the following principle should underpin Australia's future tax system in relation to Australians financial security and independence:

- Australia's tax system should address underinsurance.

4.1 Addressing the protection gap

There is considerable concern about rising levels of Australian household debt, particularly in the current economic environment. Insurance should underpin family financial plans as it provides financial protection in times of needs. Many families would struggle under the burden of this debt and have to re-assess their living arrangements and children's education if either parent were to fall seriously ill or die.

The importance of appropriate life insurance cover is heightened by these rising levels of Australian household debt, which is rated the fourth highest of the developed countries.

Recent research found that Australian parents with dependant children were critically underinsured by $1,370 billion dollars in life cover and 2.47 million families were open to the risk of financial hardship if either parent died. Nearly 70 per cent of people in small business were not insuring their most important asset - their income[18].

The Superannuation Guarantee (Administration) Act 1992 requires a default fund to offer a minimum level of life insurance cover. However the cover that people may have in their superannuation fund often gives them a false sense of security as many believe they have more protection than is actually the case. Recent research found the average level of cover provided through superannuation represents just 20 per cent of the needs of the average Australian[19]. Australians need to be made aware of this issue, perhaps through greater information from superannuation funds.

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[16] ANZ Report: *Understanding personal debt & financial difficulty in Australia*, November 2005
[17] Mercer Wealth Solutions, Simple Super Research, May 2007
[18] Investment and Financial Services Association, *Life Insurance Headlands Statement*, 2007
[19] Rice Warner Actuaries, *Cost of underinsurance report*

The implications of the underinsurance problem for individuals and the Australian society should not be underestimated or ignored. The unforeseen loss of income through death, illness or disability, can leave a family with no other option than to rely on Government benefits.

The FPA suggests the Government consider the following policies to assist in addressing underinsurance:

- Extend the requirement to have minimum compulsory life insurance cover beyond the default superannuation fund to all superannuation accounts.
- The minimum cover required under the SIS Act should be based on a consistent formula rather than the current lump sum requirement. There should be one formula for death cover and one for Total and Permanent Disability cover.
- If the Superannuation Guarantee is increased above 9 per cent, part of this increase should be used to increase the level of insurance.
- Provide a tax rebate on insurance premiums for low income earners.

4.2 Simplification of the insurance tax system

Life, Total and Permanent Disability (TPD), trauma and income protection insurances incur different tax treatment depending on the type of policy and how it was purchased. Different tax treatment applies to insurance purchased:

- within a superannuation account;
- as a group policy outside the superannuation system;
- by a self-owned business; and
- by a company.

For example, the different CGT treatment of various types of insurance policies. The non acceptance of disability and trauma policies as life insurance policies for the purposes of the exemption under s118-300 of the CGT provisions in the 1997 Act is particularly complex and inequitable. This is particularly relevant in business owner applications such as business continuation ("Buy/Sell") insurance where death, TPD and trauma cover are usually packaged together to achieve various cost and administrative efficiencies. These efforts are frustrated by the different CGT treatment.

In the case of employers, consideration should be given to the implications of fringe benefits tax on insurance premiums, and how the benefits payable under the policy are treated as an eligible termination payment which essentially devalues the final benefit.

The FPA suggests that addressing the anomalies and complexities of the tax treatment of insurance would greatly assist in closing the protection gap.

5. Facilitating a strong and internationally competitive tax regime

The FPA commends the Government on its announcement of the Australian Financial Centre Forum and for referring the Board of Taxation to undertake a broad review of the managed investments taxation regime. These initiatives will address the opportunities to enhance the international competitiveness of the Australian financial services industry.

The FPA believes the following principles should underpin Australia's future tax system in relation to Australia's global standing:

- Australia's tax system should be internationally competitive and promote Australia as a financial centre.

5.1 Tax avoidance

The FPA believes the existence of so many specific anti-avoidance rules are the underlying cause of the complexity, inefficiency and inequity problems within our tax system. While anti-avoidance measures play an important role in ensuring the integrity of the tax system, the abundance and nature of such rules have created a complex environment which serves to disadvantage honest taxpayers and drive up compliance costs for the community.

The FPA suggests Australia's future tax system should move away from the tax avoidance focus currently used when drafting tax law. Rather, attention should be given to removing many of the unnecessary anti-avoidance laws and creating a simple, efficient and equitable system for all Australians.

5.2 Rationalise Federal, State and Local taxation

Every individual and business in Australia is currently hit by taxes from all three levels of Government – Federal, State and Local – which drives up administration and compliance costs for the community. The FPA believes rationalisation and harmonisation between the tax systems and tax rates, for example the stamp duty payable on insurance, real property contracts, inter alia, which vary across jurisdictions, would significantly reduce inefficiencies for the benefit of all parties. This would also address one of the key objectives of the Government's review of the tax system - affordable housing.

The Financial Industry Council of Australia (FICA)[20] has recently published research on the efficiency of State taxes[21]. The research highlighted that the reform of State taxation is one area where the national benefits are large and the policy options involving the Commonwealth and State cooperating together are achievable. The FPA agree that inefficiencies in the range of taxes applied should be addressed.

The FPA recommends consideration be given to the arrangement for collecting taxes and whether a single collecting authority would be appropriate.

5.3 Imputation credit system

The abolition of the double tax of dividends was one of Australia's major tax reforms of the last 50 years. This should not be compromised. The fact that other countries have made their imputation systems less efficient and less tax neutral should not be something Australia copies.

Full imputation gives Australian companies access to Australian capital on neutral terms compared to other possible investments which investors such as superannuation funds might take up. If the imputation system is undermined, one could predict a decline in local support for Australian companies, reduced investment in Australia, and a potential exodus of Australian multinational companies to other jurisdictions should they lose support in their home country. The imputation credit system anchors Australian companies to home soil.

In other jurisdictions without a neutral imputation system, such as the UK and US, some company groups have sought to emigrate the holding company's tax domicile.

Under the present regime, there may be some bias for Australian companies to offer shares in overseas subsidiaries to foreign investors, thereby depriving Australia of the chance to increase national income from foreign investments.

The FPA recommends Australia improve its imputation system by ensuring that foreign tax credits can flow through to shareholders by being recognised as payments of company tax liabilities, which should be counted in the company's franking credit account.

This would remove any bias against Australian shareholders being able to fund the overseas growth of Australian multinationals. It also improves the portfolio allocations available to domestic investors if they can invest overseas through Australian companies rather than being forced to invest in overseas companies to obtain overseas asset balancing of their portfolios.

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[20] FICA is a body comprising the Australian Bankers' Association (ABA), Abacus–Australian Mutuals, Australian Finance Conference (AFC), Australian Financial Markets Association (AFMA), Financial Planning Association (FPA), Investment and Financial Services Association (IFSA), and the Insurance Council of Australia

[21] Report by Access Economics Pty Limited for Financial Industry Council of Australia, *Analysis of State Tax Reform*, October 2008

5.4 Discretionary trusts

The main objective of introducing the imputation system in Australia was to remove double taxation of company dividends from our tax laws. However under the current system franked dividend credits received by discretionary trusts or other non-fixed trusts are prohibited from flowing through to all beneficiaries, resulting in the dividends being double taxed. This may have unintended or unexpected consequences. For example, many unit trusts may not be "fixed trusts" and many family discretionary trusts may not be "family trusts" as required to obtain flowthrough of imputation credits.

A franking credit is just like a PAYG refund. People should be free to use them as they choose, as long as they disclose the dividend on their tax return.

The FPA believes all trusts should be treated the same. Franking credits are permitted to flowthrough to beneficiaries of other trusts, partnerships and companies. The FPA recommends the tax laws should be amended to allow franking credits to flowthrough discretionary trusts without the family trust election principles in the same way, provided the trustee has held the shares for the required period (ie. 45 days).

5.5 Small business tax concessions

The FPA welcomes the recent improvements to the CGT small business concessions but notes that they are still extremely complex and difficult for taxpayers to understand, as highlighted in the Architecture paper. The FPA believes the process of reform could proceed further.

For example, one of the areas of most difficulty is goodwill which is, for small businesses, at least something of a 'phantom asset' and often has no real market value. Because small business goodwill is notoriously dependent on the personal qualities of the proprietors and is often unsaleable, the operation of the small business concessions would be simplified if goodwill were to be disregarded as an asset for Capital Gains Tax purposes.

The FPA suggests that further improvements are required to the CGT small business concessions, and recommends disregarding goodwill as an asset for Capital Gains Tax purposes.

5.6 Australian expatriates with Self Managed Superannuation Funds

Currently where the majority of trustees of a Self Managed Superannuation Funds (SMSF) are temporarily absent from Australia for greater than two years, the fund is likely to fail the central control and management test. This means that the SMSF becomes a non-complying superannuation fund and therefore loses its concessional tax treatment. Members of public offer funds who are temporarily absent from Australia for more than two years, are highly unlikely to suffer the same tax penalties.

Given the global nature of business, the FPA believes this tax treatment is an inequitable anomaly. We recommend a simplification to these provisions to make it easier for individuals to work overseas and retain their benefits in a concessional taxed SMSF in Australia.