Submission to Treasury on the objective of superannuation

27 March 2023

Key points

- A definition of the purpose of superannuation should be set in the context of achieving the highest possible ratio between the numbers of Australians who can be financially independent in retirement and old age and those who will continue to be reliant on the Age Pension.
- A target should be set for the proportion of Australians who can achieve self-reliance through savings encouraged by tax incentives so the success of the superannuation system can be measured over time.
- Government should consider age pension costs, aged care cost and retirement savings incentives in one budget bucket and get a better mix between the cost of welfare and boosting savings.
- Government should acknowledge the wider economic and social benefits of a large pool of capital invested in Australia.
- The Government's intended further increase in superannuation earnings tax will not affect most superannuation fund members. It is aimed at SMSFs, the most successful sector in terms of delivering greater self-reliance in retirement and old age.
- Claims that high income earners get an unfair benefit from superannuation tax concessions ignore the fact they pay much more tax in the first place.

Purpose

The Treasury consultation paper says defining an objective for superannuation is a "foundational issue".

It seems reasonable to expect the purpose of superannuation to be defined in legislation yet it is interesting that a $3.3 trillion sector of the economy - twice Australia's GDP - has developed over the last 30 years without such a purpose needing to be defined.

Since compulsory superannuation was introduced in 1992, a large volume of law, tax and administrative rules has been developed by government and regulators to govern the superannuation system - 308 pages in the SIS Act alone.

Lack of a definition of purpose has not been a hindrance to government control and frequent, often unsettling, changes to the system. For example, the transfer balance cap set in 2017 and the intended higher cap in 2025.

Parliament has not given any priority to defining the purpose of superannuation. The "substitute and supplement" definition proposed by the Financial System Inquiry in 2014 was introduced in legislation in 2016 but lapsed in 2019.

If a definition is needed, it ought to be more precise and purposeful than a simplistic statement that superannuation is to "substitute and supplement" the age pension or a motherhood reference to a "dignified" retirement.

To have real meaning, an objective should be comprehensive, take into account whole of life income needs, and set a performance goal for the retirement income system.

Adequacy.

Ideally, the superannuation system should provide an adequate income for all Australians to meet their living costs in retirement and also in the last stages of life which may well be costly in terms of aged care.

Of course, many Australians may never have the financial capacity to fully fund all their years in retirement and in their old age, even with tax incentives. However, an aspirational goal can and should be set in any definition of the purpose of superannuation and progress towards such a target measured.

The 2021 Intergenerational Report published by Treasury noted that the proportion of Australians reliant on the full age pension is expected to decline by 10% by 2060. While this trend is in the right direction, it is offset by an increase in the number of people dependent on a part-pension, projected to rise by 25%.

By 2060, the Report predicts that 40% of older people will still be dependent on a full or part-time pension at direct cost to the taxpayer. Of course, much can happen between now and then to alter this course one way or the other.

According to the Report, around 2040 the cost to the budget of superannuation tax concessions will exceed the cost of the age pension.

This is usually portrayed as a problem but it should not be seen that way. Age pension and superannuation tax costs are just different elements of the same challenge - supporting Australians in their advanced years.

It’s better for government to spend more on tax concessions to help people to help themselves than for the budget to carry the deadweight of the age pension and aged care. The policy aim should be to progressively change the mix so self-funding, with the help of superannuation tax incentives, becomes predominant and reliance on the age pension becomes less so.

The aim should be to reduce the overall demand on the budget and the best way to do that is to increase the capacity of people to save via superannuation so more are able to be financially independent.

One important element the government should include in a definition is to set a target for the proportion of the population who will be able to become self-sufficient via their superannuation savings, with the help of tax incentives, throughout their retirement and old age. Determining and achieving this target will require well-directed and consistent policy based on good forecasting and sound economic principle.

If Treasury expects that 40% of people will still be dependent on the age pension to some degree by 2060, then a reasonable long-term target for self-sufficiency might be 66.6% reducing any level of dependency on the age pension to one third.

Another approach is to set an income target in retirement, generally accepted in the OECD as around 70% of pre-retirement earnings.

Balance caps

The Government has announced it will introduce a new, higher balance cap from 2025 but without much detail at this stage. This is clearly targeted at relatively high-balance self-managed superannuation funds to stifle the growth of the most successful sector of the superannuation system in terms of achieving financial independence in retirement and old age.

The balance cap of $1.6 million introduced in 2017 with a new 15% earnings tax above the cap had a dramatic effect on contributions to self-managed funds.

The ATO's 2020-21 SMSF statistics report a 52% decline in contributions since the balance cap was applied in 2017.

"*The level of contributions (in 2020-21) is well below 2016–17 when member contributions were $32.2 billion and total contributions were $39.1 billion. This is largely attributed to the lowering of the contribution caps from the 2017–18 year." ATO SMSF Statistics*

https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Super-statistics/SMSF/Self-managed-super-funds--A-statistical-overview-2020-21/?anchor=SMSFprofile#Contributionsrolloversandbenefitpayments

The Government's intended doubling of earnings tax from 15% to 30% on balances above $3 million is likely to have a similar, and probably even greater effect.

However, it will not affect the the majority of superannuation fund members. It is aimed squarely at SMSFs.

If the proposed objective is adopted, the coded wording "in an equitable and sustainable way" will likely be used to justify curbing SMSF growth even further to the benefit of the large industry funds that have only now, since the 2017 earnings tax, managed to overtake SMSFs in total assets under management.

Any definition of superannuation should be directed towards sustaining an efficient and effective retirement savings system and not be used as cover to single out and attack SMSFs.

Superannuation tax incentives

Much has been made by the Government, superannuation stakeholders and commentators that a high proportion of tax incentives goes to people on higher incomes, citing Treasury's Tax Expenditures & Insights Statement which shows the top 10% of taxpayers receive 39% of the superannuation concessions. However, the Statement is qualified:

"*The tax benchmark should not be interpreted as an indication of the way activities of taxpayers ought to be taxed. A different choice of benchmarks may result in significantly different estimates of the size and distributional impact of tax expenditures."*

The claim that high income earners get an unfair share of tax concessions ignores the ATO's Taxation Statistics showing the top decile (9%) of taxpayers pay 48% of all income tax collected. 55% of taxpayers pay only 12% and 25% pay no tax at all.

The ATO shows the number of people earning $180k plus comprise just 3.6% of income tax payers but they pay 37.6% of the income tax collected.

Treasury's tax expenditures report acknowledges that people on higher incomes get a larger share of the benefit of super concessions because they pay higher marginal tax rates while the share of the benefit for people in the lowest decile is close to zero because their income is mostly non-taxable government social welfare and, if they do pay tax, their marginal tax rate is close to 15% anyway.

It's not surprising that people on higher incomes get a proportionally higher $ benefit from any tax concession.

High superannuation balances have been built up by much higher contribution limits (previously $100,000 per year and a one-off $1 million) that are not available today.

A lower annual contribution cap of $25,000 in recent years (now $27,500) is not going to generate such high balances in the future.

There is, naturally, a focus of interest on abnormally high balances. For example, ASFA claims there are 27 super funds each holding more than $100 million. How would they know? But if true, there may be many reasons, including the longevity of funds (super has existed for a century) and the transfer of large amounts from family trusts, windfall profits etc before 2006 when contributions were unlimited and after-tax contributions.

Whatever the reason, these fund balances are rare and exceptional. They may be titillating to the media and politicians but are not relevant to tax policy for the great majority.

The 2020-21 ATO statistics show the number of SMSF members with balances of more than $5 million was 1% (about 100,000 people). Most - 94% - had balances of less than $1.6 million, lower than the transfer balance cap set in 2016/17 below which superannuation earnings were not taxed.

If a very small number of high balances is a problem, it is a transitory one.

That is not to say that caps on superannuation balances and progressive tax rates on fund income can not be contemplated.

However, they should be in the context of a clear and coherent statement of the purpose of superannuation.

In particular they should not be made retrospective in effect by changing the tax treatment under which people have, so far, saved for their retirement.

Taxing unrealised capital gains

The reported intention of the Government to tax unrealised capital gains is astonishing, alarming and a very bad precedent. It will be a killer blow to self-managed funds and may drive trustees to shift funds elsewhere. Company shares, property values and other investments in Australia will be pounded at a time when global financial markets and asset values are under pressure.

The Government should clarify its intentions with regard to the taxation of unrealised capital gains well before Budget night.

In considering the purpose of superannuation and its taxation, the Government should bear in mind the overall advantages to the economy and the well-being of the community of a large pool of capital substantially invested in Australian company shares, Australian banks & financial markets and managed superannuation funds.

Directed investment

The Treasury Consultation Paper notes a “significant opportunity for Australia to leverage greater investment in areas where there is alignment between the best financial interests of members and national economic priorities.”

Directed investment of retirement savings is a very bad idea. Superannuation investment decisions should be left to trustees and fund managers who already have an obligation to make investment decisions in the best interests of members. This obligation should not be over-ridden by Government. Nothing could shake confidence more than government intervention and interference.

Superannuation belongs to members, albeit with the benefit of tax incentives, and they entrust the investment of their savings to fund trustees and managers - not to the Government.

If the Government wants superannuation funds to invest in national infrastructure projects it should do so via market mechanisms, e.g. Government or attractive corporate issued bonds, that offer clear investment benefits for superannuation funds of all types.

The success of the Future Fund with consistent growth in assets (until the past year when global markets have been volatile) has been achieved by an independent Board with a return on assets target set by the Government but, properly, no instructions on how to achieve it. Superannuation funds should not be treated differently.

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