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AFTS Secretariat
The Treasury
Langton Crescent
PARKES ACT 2600

By email: AFTSretirement@treasury.gov.au

Dear Sir/Madam

Australia's future tax system retirement income consultation paper

CPA Australia represents the diverse interests of more than 122,000 members in over 100 countries. Our vision is to make CPA Australia the global accountancy designation for strategic business leaders. We welcome the opportunity to again provide input into the review of Australia's future tax system, this time with a focus on the Australian retirement savings system.

This submission has been prepared with the assistance of CPA Australia's Financial Advisory Services Centre of Excellence, a group of leading experts from the superannuation and financial planning industries.

CPA Australia believes the current structure of Australia's retirement savings system – that is, the three pillars – is appropriate to meet our retirement savings goals. However, the challenge will be to get the mix right between the three pillars to ensure retirement savings are adequate for individual Australians to maintain a reasonable standard of living in retirement, while also ensuring the system is simple, efficient and equitable.

We are cognisant the current economic environment may not permit reform in the short-term, nor may it be appropriate considering the constant change experienced by the system in recent years and the need for stability to maintain the community's faith in the system. However a long-term focus must be maintained. This review is an opportunity for government to make a commitment to a long-term reform program to deliver a system that will achieve these goals.

The attached document contains our responses to the questions asked in the consultation paper. Through these responses we set out our views on how the system can be improved, particularly focusing on adequacy, reducing complexity and improving equity. Significant issues addressed in our responses include:

- The primary objectives for Australia's retirement savings system should be to alleviate poverty, provide mechanisms to assist and encourage self-funded retirement savings and insure against risk.

- The ideal retirement savings system needs to be simple, sufficient and sustainable.

- The ‘three pillars’ system is an appropriate structure to meet these objectives. However, there are many areas of complexity that detract from the efficiency of the system.

- As the SG system matures, the first pillar - the age pension – needs to shift back from supplementing the compulsory system to being a genuine safety net.

- Government assistance to encourage retirement savings should be primarily targeted at low and middle income earners.

- Assistance needs to be provided to individuals on the fringe of the compulsory system by improving access to, and the efficiency of, SG contributions, extending access to the co-contribution and providing more flexible contribution limits.

- Compulsory superannuation should be extended to the self-employed and the ‘10% rule’ for claiming a tax deduction on contributions be removed.

- Retirement savings goals may best be achieved at an individual level. End benefit projections would assist individuals to determine their retirement savings needs.

- Ideally total contributions levels should be around 12 to 15% of gross income. This should be a mix of compulsory and voluntary contributions and government assistance.

- Over time, the balance of tax concessions needs to shift from high to low income earners and the tax burden shift from the contributions phase to the benefits phase.

- Over time, the preservation age and threshold for tax free superannuation benefits should be aligned with the age pension age.

- A retirement income stream culture needs to be encouraged. Some compulsion may be required.

Also attached in Appendix A is an extract from our submission to the Panel on 17 October 2008 relating to superannuation and retirement savings.

If you have any questions or to discuss the above matter, please do not hesitate to contact Michael Davison, senior policy adviser - superannuation, on 02 6267 8552.

Yours sincerely

Paul Drum FCPA
Director, Policy and Research

cc M Davison

Australia’s future tax system retirement income consultation paper

Consultation questions

The retirement income system

Q1.1 In considering the future of Australia's retirement income system, which objectives are relevant in setting retirement income policy? Does the current system of the Age Pension and compulsory and voluntary savings meet these objectives? If not, how should the system be changed to meet these objectives?

We believe the primary objectives are threefold:

1. The system should provide assistance and incentives for individuals to save sufficiently and effectively in order to maintain a reasonable standard of living throughout their whole life cycle, i.e. to provide mechanisms to smooth income and hence consumption through both their working life and retirement.

2. Where individuals have not had the means to save sufficiently, the system should provide adequate support to alleviate poverty.

3. to provide insurance to protect retirees from certain risks, such as longevity, investment, inflation and system failure.

An ideal retirement savings system should display three primary characteristics. It should be simple, sufficient and sustainable.

- Simple – the system should be free from complexity in both design, implementation and operation. The average person has to be able to understand it if they are to accept it and engage with it.
- Sufficient – to provide an adequate level of retirement savings to maintain a reasonable standard of living in retirement.
- Sustainable – not only in the sense of being able to maintain government support and expenditure for future generations but to also be robust to withstand external shocks – such as the current financial crises – and maintain equity to ensure continued support and engagement of the system thus minimising the risk of future system change.

We support Australia’s ‘three pillars’ retirement savings system and believe it is the appropriate systems to meet these objectives. However, the challenge is to get the mix right between the three pillars and to ensure proper integration.

Our primary concern is with the first pillar – the age pension. The first pillar has always been represented as a ‘safety net’ for those individuals who have not had the means to save sufficiently for themselves. However, there has been a very real shift, and acceptance, so that the age pension is supplementing the compulsory system (or vice versa) to the point where some 80% of retirees are receiving at least part of the age pension. This is understandable at the moment as current retirees have not had the benefit of a mature SG system. However, as the SG system matures this dependency needs to be wound back so that by the time the system has fully matured, around 2035, the age pension is only being provided as a genuine safety net for those members of society in genuine need.

A broad and adequate retirement income system

Q2.1 As the SG system matures, it will become a greater part of an employee's retirement income. What are the implications for individuals partially or fully excluded from the mature SG system (the self-employed, individuals with broken work patterns such as carers, women and migrants), and how can the retirement income system best accommodate these groups?

Modelling conducted by the National Centre for Social and Economic Modelling (NATSEM)[1] for CPA Australia shows the 9 per cent compulsory superannuation guarantee will only provide an adequate standard of living in retirement for an individual on average earnings under ideal conditions where they enjoy compulsory superannuation contributions for their entire working life and are also in a position to make voluntary savings (see Appendix A - section 1).

For individuals with broken work patterns, the replacement rates from SG can be considerably lower and may not be sufficient to maintain standards of living in retirement. In many cases there may be no option than to rely on the age pension. However, where possible assistance should be given to maximise the savings they do have and to facilitate additional savings. This can be done through a combination of measures, which were fully outlined in our first submission (see Appendix 1):

- Remove contributions tax for low and middle income earners by way of a rebate to superannuation accounts (Appendix A, section 1.1). Removing contributions tax will increase replacement rates for low income earners by 5 to 6%.

- Extend the co-contribution scheme to individuals outside of the paid workforce (Appendix A, section 1.2),

- Remove the minimum SG threshold of $450 per month and replace it with a one month only threshold of $450 (see Appendix A, section 1.3).

- Provide the ability to catch up on missed contributions while out of the workforce or earning a low income by allowing for a rolling concessional contribution cap, similar to the three year provision for non-concessional contributions, or a lifetime contribution cap. For similar reasons, the transitional $100,000 concessional cap for individuals over age 50 should continue after 2012.

There may also be a case for replacing, or supplementing, the co-contribution for voluntary contributions for low income earners (say, below $30,000) with either a co-contribution matching compulsory employer contributions or an automatic annual government contribution. In the case of the later, it could be further means tested against the spouse's income to ensure against excessive spousal support.

In the case of the self employed, it is difficult to argue against extending compulsory superannuation to also cover them. However, incentives also need to be provided to encourage them to contribute above the compulsory amount and to ensure they have equal access to the tax concessions provided to employees.

[1] NATSEM, CPA Australia, *Superannuation: the right balance?*, 2008

It is sometimes argued that many self employed people save for their retirement through their business and that this can generate a valuable retirement benefit. However, statistics on business exits indicate this is a high risk strategy as the individual's retirement income is linked to the operation and success of their business. While a small business may be successful for the purpose of providing income while self-employed, there is no guarantee there will be a buyer for that business at the time that the individual wants to retire. The Productivity Commission in its report 'Business Failure and Change in Australia' found that only 50 percent of small businesses continue to exist after 10 years and the Australian Bureau of Statistics also found that only 43% of business operators (as opposed to businesses *per se*) had been operating their business for ten years and of that figure 49% had been operating their business for 20 years[2]. While a percentage of these business may be profitable there may be barriers to an orderly transfer. This implies there is a significant risk of the self employed having all their savings in the one basket. Therefore, it is imperative that independent superannuation savings are provided for and encouraged.

As such, we recommend the self-employed be required to contribute the equivalent of at least 9% of their annual pre-tax income to superannuation. In addition, concessions continue to be provided to assist in meeting this minimum and to encourage additional savings. These current concessions are access to the co-contribution and deductibility of contributions.

In the case, of the deductibility of contributions, we also recommend the removal of the '10% rule' (see Appendix A, section 2.1). This is because the hybrid self-employed (ie. individuals who are both self-employed and employed at the same time/during the same year) are discriminated against under the combined effect of the contribution capping ruling and the 10% rule.

Employment arrangements have become more flexible with many people employed under casual or contracting arrangements. Those who consider themselves largely self-employed have found they may have lost their eligibility to claim a deduction for superannuation contributions after taking on relatively small consulting or contracting roles. This is being further exacerbated by legislation currently before Parliament, which will now include salary sacrifice contributions as income when determining the 10% threshold. There is often a double whammy effect in that these contracting roles will only pay superannuation guarantee (SG) contributions and there is no provision for the contractor to make voluntary or salary sacrifice contributions. The result is individuals may end up with minimal superannuation coverage since they do not have any more than SG coverage from their employment, and they are not able to claim a deduction for their own contributions. These individuals are at a distinct disadvantage compared to those who are full-time employees or full-time self-employed.

The other group that has not been considered is non-home owners. Our NATSEM research shows renters are on average 17% worse off than home owners in retirement, primarily due to the ongoing housing costs they must meet. Single renters, in fact, fall just below the modest but adequate standard of living in retirement when relying solely on the SG. Boosting SG through removing the contributions tax for low income earners would assist these people, as would incentives for voluntary savings. There is also a place for financial literacy to ensure they are aware of the greater need for voluntary saving. Where additional savings are not possible, government must ensure the safety net is sufficient to meet their additional retirement savings needs.

[2] ABS publication 'Australian Small Business Operators – Findings from the Characteristics of Small Business Survey 2005-06'

Q2.2 Noting that the adequacy of the Age Pension is being considered by the Pension Review, what is an appropriate concept of adequacy for the retirement income system? Should it be to ensure there is a minimum level of income in retirement, to replace a proportion of income earned prior to retirement, or some other alternative?

As stated in our response to Question 1.1, we believe the system should provide assistance and incentives for individuals to save sufficiently and effectively to be able to maintain a reasonable standard of living throughout their whole life cycle. In other words, there should be a certain level of income replacement in retirement. Underpinning this, the system should provide a minimum level of support to alleviate poverty for those who have not had the means to save sufficiently.

It is difficult, if not impossible to determine a single replacement rate target as each individual's or couple's needs will be different in retirement and are influenced heavily by factors such as home ownership, desired lifestyle and health. However, it is unlikely a 100% replacement rate is necessary.

As a starting point, our NATSEM modelling shows the mature SG system will provide replacement rates in retirement of 92 to 98% for low income earning individuals and 75 to 81% for middle income earners under ideal conditions. Everyone's needs are different but when compared to the Westpac ASFA Retirement Standard these replacement rates would provide a reasonable standard of living in retirement.

The challenge is to boost the retirement savings of those who won't enjoy the benefit of the SG system under ideal conditions, as outlined in Question 2.1. Where this is not possible, the government must ensure the safety net is adequate to maintain a modest standard level in retirement. What the level of the age pension should be we will leave to the Harmer inquiry.

For individuals who have the means, if the replacement rates provided by a mature SG system are not adequate to meet their own personal needs, it will be up to them to make voluntary contributions on top of the SG, with appropriate Government assistance through incentives, to meet their retirement savings goals.

Given the difficulty in determining a single retirement savings target, we believe end benefit projections would provide valuable assistance for these individuals in determining what their retirement savings needs are and how their saving are actually tracking against their goals so they can adjust them accordingly.

Q2.3 What should the role of the government be in assisting individuals to meet their retirement income expectations in relation to the support provided by the Age Pension, the level of compulsory savings and incentives to make additional savings? Should the role of government change as an individual's income increases over their working life?

We believe it is the government's role to provide:

- appropriate mechanisms to assist and encourage individuals to save sufficiently to maintain a reasonable standard of living in retirement; and
- an adequate safety net for individuals without the means to save sufficiently.

The government's role should not change as income levels increase. However, the nature and level of assistance should vary with income levels. Assistance should primarily be targeted at low and middle income earners - those who may have difficulty saving unassisted due to competing demands and lower disposable income, and those unable to provide for themselves. Assistance should be provided to higher income earners but only to the extent of achieving a reasonable standard of living in retirement. As they have a higher propensity and ability to save, and may still do so even without incentives, it would be inappropriate to assist them to fully achieve full income replacement in retirement.

An acceptable retirement income system

Q3.1 Do the settings of the retirement income system, such as the level of SG and access to concessions, adequately consider the needs and preferences of individuals both before and after retirement?

Our research shows a mature SG system will provide a reasonable standard of living in retirement for middle income earners under ideal conditions. Considering very few people will experience ideal conditions, we believe contribution levels should be in the range of 12 to 15% of gross income. However, lifting compulsory contributions levels for low and middle income earners may have an adverse effect on pre-retirement living standards, particularly for low income earners. While low income earners may enjoy better than full replacement rates in retirement, they may not have sufficient disposable income to cover the fall in pre-retirement income resulting from the additional contributions. As such, we do not advocate lifting the level of SG but instead suggest improving the efficiency of the current SG system and ensuring adequate incentives are in place to encourage voluntary savings by those individuals who have the means to do so.

As mentioned in our response to question 2.1 and outlined in Appendix A – section 1.1, the efficiency of the SG system could be improved by removing the contributions tax on SG contributions, by way of a rebate, for low and middle income earners.

To encourage greater voluntary savings we advocate extending the co-contribution for middle income earners (see Appendix A – section 1.2) and the introduction of soft compulsion, i.e. opt –out contributions rather than opt-in (see Appendix a – section 1.4).

As also mentioned in our response to question 2.1, the self-employed are in need of greater assistance to contribute to superannuation. To ensure this group have adequate coverage, we have suggested the removal of the '10% rule' for determining eligibility to claim a tax deduction for contributions (see Appendix A – section 2.1). The advantage of this, in addition to more self-employed qualifying, is that all workers, employed and self-employed, would be able to claim a tax deduction for the super contributions, and have much greater flexibility to determine the most tax effective means of contribution to superannuation. This would also address the problem that many employees are not able to make salary sacrifice contributions. The contribution caps as they exist would limit the concessional treatment of contributions made, with no benefit to be gained from contributing above the limits.

Q3.2 Is the current level of superannuation income tax concessions appropriate and sustainable into the future? Are the current concessions properly targeted, and if not, how should they be reformed?

Ideally, the most equitable retirement savings system would follow an exempt/exempt/taxed taxation model whereby income is taxed in the hand of the individual when it is actually received. Unfortunately, the current system may be too far entrenched to reach that but some changes could be made to get closer to the ideal.

The current tax concessions, particularly since the simpler/better superannuation changes, are heavily skewed towards high income earners, with low income earners getting little, if any benefit. For example, removing the tax on end benefits benefited individuals with high balances, who may have paid excess benefits tax, but provided no benefit to individuals with low balances as they were already able to take advantage of the tax-free threshold or did not have benefits that exceeded the reasonable benefit limits. Similarly, individuals on the 15% marginal tax bracket get no advantage from not paying tax on their benefits as they still pay 15% tax on their SG contributions.

We acknowledge the removal of end benefits tax from age 60 may have been appropriate in the short term as current and imminent retirees have not had access to a mature SG system and the removal of benefits tax has boosted low retirement savings. However, as the system matures we believe it would be appropriate to rethink this position in the long term and consider shifting some of the tax burden from the contributions phase to the benefits phase, albeit with a long transition phase.

A long lead time for change is also needed to minimise any disadvantage for the current generation who haven't had the SG all their working life, have only had low age-based deduction limits, haven't had the government co-contributions in their younger working years, have had the surcharge, and won't get the transitional concessional contribution caps. Too many changes too soon may see this age group becoming the disadvantaged group as they were either too young or too old to gain any advantage from recent positive reform but have experienced many of the negative measures.

In the short term, to address the lack of tax concessions for low income earners, we suggest a rebate of the contributions tax as outlined in section 1.1 of Appendix A.

The other area of inequity in the provision of tax concessions is the treatment of untaxed benefits. The continuing taxation of these benefits compared to taxed benefits is higher than the foregone contributions tax it is meant to replace plus there is still effectively a de-facto RBL system in place. Members of unfunded schemes, such as members of the public sector schemes, continue to be disadvantaged compared to their taxed fund equivalents.

A robust retirement income system

Q4.1 At what age should an individual be able to access their superannuation and at what age should they become eligible for the Age Pension?

To ensure retirement savings are maximised for use in retirement we would support a gradual increase in the preservation age for compulsory and government funded contributions, ie the co-contribution, to align with the age pension age, currently age 65. We would support earlier access for voluntary contributions, provided it did not add any unnecessary complexity.

We recognise individuals in many vocations, particular the trades and blue collar industries may not be physically able to work to 65 and often need to retire early. We suggest the conditions of release be modified to align with this need, possibly aligning with the current eligibility for disability support. We also support the continuation of the transition to retirement provisions, however they should be tightened to ensure they are only being utilised by individuals actually transitioning from full-time employment to retirement.

To encourage greater workforce participation, we also suggest the threshold for tax free benefits be aligned with the increase in the preservation age so that ultimately it would also be age 65.

We do not have an opinion on increasing the age pension age but imagine it would meet with widespread community opposition. However, consideration should be given to incentives to encourage people to work past age pension age and/or defer commencement of the age pension. While the pension bonus scheme provides some encouragement, it can be difficult to access, has had low take up and does not encourage self-funded retirees. One option may be a rebate, similar to the Senior Tax Offset, that can only be applied against ‘gainfully employed income’ to target individuals still in employment and prevent access by ‘wealthy’ retirees who may use it to offset investment income.

Q4.2 What is the role of individuals in dealing with investment and longevity risk in accumulating and drawing down their retirement income? Do financial markets provide the means to deal with these risks? If not, is there a role for government to address these shortcomings?

With the move to a defined contribution system and choice of fund, the responsibility for investment and longevity risk has shifted to the individual. In turn they must look to the financial markets to minimise these risks. While the financial markets provide products and diversification to minimise investment risk, there are very few products (if any) available to reduce longevity risk. This is partly due to legislative restrictions and partly due to the lack of sufficient underlying long-term investments, such as government bonds to underpin these products. Also, many of the traditional life-time product providers have moved away from providing life-time products as they are adverse to carrying investment and longevity risk on these products.

The other factor that has increased longevity risk has been the move away from encouraging lifetime income streams in retirement. Prior to the simpler/better superannuation changes there were tax concessions to encourage income streams and limits on the tax concessions for lump sums through the RBL system. Currently there is no incentive or compulsion to take an income stream over a lump sum.

We would support retirees being compelled to take a small proportion of their total benefit as an income stream, while still allowing access to a lump sum for large expenses, retiring debt, etc. We would suggest a requirement for 20% of their retirement benefits be used to commence a lifetime indexed pension or to purchase insurance to guarantee a future income stream commencing from a certain age, say 80 or 85. Individuals with smaller account balances, say $200,000 would be exempt from the requirement. However, there is still the issue of encouraging the market to provide such products.

Ultimately, the government provides insurance against longevity and investment risk through the age pension.

A simple and approachable retirement income system

Q5.1 In what ways does the retirement income system impose undue complexity and cost on retirees and workers? How could this complexity be reduced?

Despite Australia’s three pillars retirement savings system often being considered world’s best practice, many areas of complexity exist on the periphery that detract from the efficiency of the system. While the simpler/better superannuation changes addressed some complexities, many still exist and new ones were even created as a result of the changes.

These include the following areas that were fully outlined - with suggested solutions - in our first submission (see Appendix A, section 2):

- The arbitrary nature of the 10% rule for the self employed, where one contracting role may see them losing the ability to claim a deduction on their contributions (Appendix A, section 2.1).

- The inconsistent access to tax concessions on pre-tax contributions. Not all employees have access to salary sacrifice and not all self-employed are able to claim a deduction. Removing the 10% rule and being able to claim a deduction would give all workers an equal ability to maximise the concessions on their contributions (Appendix A, section 2.1). The Government's new rules concerning the inclusion of salary sacrifice contributions in various income tests creates even more confusion/complexity.

- The taxation of death benefits is inequitable and disadvantages individuals who do not have the knowledge or advice to adopt schemes to avoid it (Appendix A, section 2.2).

- Individuals attempting to bring retirement savings benefits into Australia from overseas are severely disadvantaged by the contribution limits (Appendix A, section 2.3).

In addition, there is the treatment of untaxed benefits mentioned in our response to question 3.2.

Other areas of inequity and unnecessary complexity within the superannuation system include:

- The imposition of the employment rules for contributions after age 65. These requirements limit the ability for individuals to flexibly move into and out of employment and retirement after age 65 and make it impossible to move inheritances into superannuation if the recipient is not working. This is a particular issue for widows who should be encouraged to maximise their retirement savings to counter their greater longevity risk.

- Individual entering/leaving Australia who were temporary residents have an extremely complex system to negotiate which ultimately ends up with the individual paying tax on their Australian super well in excess of the highest marginal tax rates simply because they are temporary residents and no other reason.

- The lack of CGT rollover relief for fund mergers and transfers is an impediment to fund consolidation and has a particularly detrimental effect on self managed superannuation fund members who may wish to, or are forced to wind up their fund and move to a commercially provided fund. There has already a precedent for CGT relief where SMSFs are split on divorce.

- The definition of 'Australian superannuation fund' may disadvantage Australians travelling overseas for employment reasons for greater than two years even though it is their intention to return permanently in the future (see Appendix B).

In all, if all these issues could be addressed, the system would be a lot less complex, more equitable and easier to understand and engage with.

A sustainable retirement income system

Q6.1 The Age Pension serves two roles, as a safety-net for individuals who are unable to sufficiently save for their retirement and as an income supplement for many individuals who do save. What should be the role for the Age Pension and means testing in a future retirement income system and what impact does this have on its sustainability into the future?

See response to question 1.1.

Q6.2 In what ways does retirement income policy affect workforce participation decisions and what, if any, changes might reduce disincentives to work? Does the sustainability and cost of the retirement income system affect the workforce decisions of younger generations of workers?

Early access to retirement savings and access to tax free benefits may encourage early retirement. As mentioned in our response to question 4.1, we would support a gradual increase in the preservation and tax free benefit ages to age 65.

Q6.3 What impact could financial intermediation have on the effectiveness of retirement income policy?

The issue of individuals using retirement savings to retire debt, as outlined in the consultation paper, is more a product of society's current inclination to carry large amounts of debt and the availability of credit products. We believe this issue needs more of a financial literacy response to change behaviour.

Appendix A: extract from CPA Australia submission of 17 October 2008

Superannuation and retirement savings

1. Improving retirement savings

There have been significant improvements to Australia's retirement savings system in recent years. Superannuation is now more accessible, benefit options are more flexible and incentives for increasing retirement savings have improved. The simplified superannuation changes will no doubt improve retirement savings. However, we cannot afford to be complacent.

Modelling conducted by the National Centre for Social and Economic Modelling (NATSEM) for CPA Australia, and contained in the report *Superannuation: The right balance?* [3] shows the 9 per cent compulsory superannuation guarantee will only provide an adequate standard of living in retirement for an individual on average earnings under ideal conditions where they enjoy compulsory superannuation contributions for their entire working life and are also in a position to make voluntary savings (see following table).

Family type	Pre-retirement Income level	Replacement Rate (%)
Single Male	Low ($34,339)	92
	Middle ($51,509)	76
	High ($77,264)	64
Single Female	Low	98
	Middle	81
	High	65
Couple (No Children)	Low	82
	Middle	67
	High	57
Couple (2 Children)*	Low	137
	Middle	120
	High	101

*Replacement rate appears high as it is being compared to the lower standard of living associated with the cost of raising children. In reality, the living standard in retirement is similar or slightly lower than that for a couple without children.

For those earning above average earnings or with broken work patterns, the SG alone will not be enough. It is recognised that a savings level of 12 to15 per cent is needed to maintain standards of living in retirement.

Further initiatives and policy changes are required if retirement savings levels are to be appropriately increased. This can be achieved by either lifting contribution rates or improving the effectiveness of existing contributions, or a combination of both.

The government has already stated its commitment to maintaining the compulsory superannuation guarantee at 9 per cent of income. However, an increase in the SG should not be ruled out if it is necessary to boost retirement savings.

If any increase in the SG was ruled out, any increases in contribution levels must come from increased voluntary contributions or government contributions. Increasing the effectiveness of contributions could be achieved by reducing or removing the tax on contributions. These suggestions are explored in more detail below.

[3] NATSEM, CPA Australia, *Superannuation: the right balance?*, 2008.

1.1 Removal of contributions tax

Low income earners – on the 15% and nil tax brackets – receive no tax benefit for making concessional contributions to superannuation – i.e. SG or salary sacrifice – as these contributions are taxed at 15% and any earnings are taxed at a maximum of 15% in the fund.

Low income earners may actually be better off receiving the extra income in their hand than in compulsory superannuation contributions. While low income earners do qualify for the government co-contribution, they may not have the disposable income available to channel towards superannuation to obtain it.

The 15% tax on the 9% SG contributions means the effective contribution to an individual's superannuation account is only 7.65%. Modelling conducted by NATSEM (see the following table) demonstrates that removing the contributions tax on SG contributions would improve replacement rates by 5 to 6% for low income earners ($34,339), 7 to 9% for average income earners ($51,509) and 9 to 14% for high income earners ($77,264).

Family type	Income level	Replacement Rate (%)	Replacement Rate – nil contributions tax (%)
Single Male	Low ($34,339)	92	97
	Middle ($51,509)	76	82
	High ($77,264)	64	70
Single Female	Low	98	103
	Middle	81	87
	High	65	73
Couple (No Children)	Low	82	87
	Middle	67	73
	High	57	63
Couple (2 Children)	Low	137	145
	Middle	120	130
	High	101	115

The simplest option may be the wholesale removal of the contributions tax on SG contributions. However, we believe it would be more equitable to cap the level of contributions at which the tax is removed, thus directing the benefit towards lower income earners. CPA Australia has considered two options for removing contributions tax, both of which would provide the majority of the tax benefit to individuals on lower income levels:

1. Remove contributions tax on SG contributions based on taxable income. The contributions tax could be removed by providing a rebate to individuals on the 30% marginal tax bracket and below. Mechanisms, such as the co-contribution and first home saver account government contribution, could be duplicated with contributions tax being rebated back to an individual's superannuation account once their eligibility has been determined following lodgement of their income tax return.

2. Remove contributions tax on a specific dollar or percentage amount of concessional contributions that is not linked to income, for example 9% of the maximum SG contribution base (currently $152,720 pa) or $13,745 for the 2008-09 financial year. Funds would be able to exclude the first $13,745 of contributions from contributions tax when they are received. If an individual were to exceed the contributions tax free threshold due to error or multiple funds, the excess could be recovered using the excess tax mechanism introduced as part of the Simpler Superannuation measures.

The disadvantage of the first option is that the incentive is not immediate in that it is provided after the event once an individual's income tax return has been lodged. Also, funds are not always able to identify SG and voluntary employer (i.e. salary sacrifice) contributions as employers are not obliged to report them separately.

The advantages of the second option are that it would provide a more immediate incentive and it is less complex. By including all concessional contributions it would provide a greater benefit to lower income earners and incentive for them to make additional contributions via salary sacrifice. It would also provide the self employed with a greater incentive to contribute to their superannuation.
However, the concession provided by the removal of the contributions tax should be limited to the accumulation phase to encourage and maximise retirement savings, not the draw down phase.

As such, we suggest the government consider removing the contributions tax on a fixed dollar amount of concessional contributions made by/ for individuals prior to them reaching their preservation age. We also suggest the compulsory superannuation be extended to the self employed, whereby they would be required to contribute at least 9% of their income each year to superannuation.

Recommendations:

- ***Remove contributions tax on a fixed dollar amount of concessional contributions.***
- ***Extend compulsory superannuation to the self employed.***

In addition to the reduction of contributions tax, there are a number of other measures to consider to raise contribution levels.

1.2. Extending the government co-contribution scheme

The government co-contribution has so far been a great success according to both government reports and anecdotal evidence from superannuation funds. With the increased coverage and more generous benefit, the co-contribution is a very positive incentive. However, it does not provide universal coverage, with individuals out of the workforce unable to access it. For example, carers, parents raising a family, students or the unemployed.

The increases to the marginal tax rates announced in recent federal budgets highlight the gap in incentives for many 'average' income earners subject to the 30 per cent marginal tax rate. While individuals earning less than $60,342 can access the co-contribution and for those earning greater than $80,000, salary sacrifice is tax effective, there are no incentives for those in between to make voluntary contributions. This could be addressed by lifting the co-contribution thresholds to be aligned with the new marginal tax rates.

Recommendations:

- ***Align the top threshold of the co-contribution scheme with the cut-off of the 30 per cent marginal tax bracket.***
- ***Extend the co-contribution scheme to individuals outside of the paid workforce.***

1.3. Abolishing the minimum superannuation guarantee threshold

The superannuation guarantee earnings threshold of $450 per month was introduced when SG commenced at a level of 3 per cent of salary. Since then the SG level has increased to 9 per cent and the workforce has become increasingly casualised.

As a result more people are at risk of being excluded from the SG system and not having access to adequate retirement savings. For example, an individual working two or three casual jobs, each earning just under the $450 threshold each month, could be missing out on SG contributions of $800 to $1200 each year.

To boost retirement savings, particularly for people with broken or casual work patterns, we recommend the SG threshold be abolished. However, we do recognise the administrative burden that may be experienced by employers when meeting their SG and choice of fund obligations for casual or itinerant employees. As such, we would be supportive of any exclusion for one-off or short-term employment situations. One solution would be for employers to only be permitted to apply the $450 threshold once for a single month for an individual employee. That is, it would generally only be utilised in their first month of employment after which if their employment continues, SG should be paid.

Recommendation:

The SG earnings threshold of $450 per month to be replaced with a one month only threshold of $450.

Three of the recommendations above – removing contributions tax on SG for low income earners, extending the co-contribution scheme to individuals outside of the paid workforce, and abolishing the minimum SG threshold – would provide a significant and immediate improvement to the retirement savings of individuals who spend extended periods out of the fulltime paid workforce, particularly parents raising children and fulltime carers.

1.4 A default scheme for voluntary personal contributions

The introduction of an 'opt-out' default scheme for voluntary personal contributions would encourage voluntary superannuation contributions and lead to improved retirement savings.

Voluntary contributions, above the compulsory 9 per cent amount, are one way to fill the retirement savings gap. The level of voluntary contributions has been falling since the late 1990s. While it is yet to be seen if the introduction of the co-contribution will arrest the decline, one way to encourage voluntary contributions would be to introduce a default scheme whereby voluntary contributions were automatically deducted from an employee's salary unless they chose to 'opt out' of the scheme. Such a scheme could commence at 1 per cent of salary and increase to 3 per cent over three years. Similar schemes operate very successfully overseas.

Recommendation:

Introduce a 3 per cent voluntary superannuation contribution scheme.

2. Simplification and equity

While the simplified superannuation changes have simplified key aspects of the superannuation system, there still remain particular areas of complexity and inequity that need to be addressed before superannuation can truly be considered simple.

The following initiatives, if implemented, would be a significant step forward in reducing complexity and inequity within the superannuation system, while further improving the adequacy of retirement savings.

2.1. Extend deductibility of superannuation contributions

The introduction of the contribution caps under the simplified superannuation changes, particularly the concessional contribution cap, provides the opportunity to remove the inequities that exist around the application of the '10 per cent rule' for claiming a tax deduction for superannuation contributions.

Employment arrangements have become more flexible with many people employed under casual or contracting arrangements. Those who consider themselves largely self-employed have found they may have lost their eligibility to claim a deduction for superannuation contributions after taking on relatively small consulting or contracting roles. There is often a double whammy effect in that these contracting roles will only pay superannuation guarantee (SG) contributions and there is no provision for the contractor to make voluntary or salary sacrifice contributions. The result is individuals may end up with minimal superannuation coverage since they do not have any more than SG coverage from their employment, and they are not able to claim a deduction for their own contributions. These individuals are at a distinct disadvantage compared to those who are full-time employees or full-time self-employed.

Abolishing the 10 per cent rule would allow employees to claim a deduction for their personal superannuation contributions. However, with full deductibility being given to personal contributions, there is essentially no difference between the treatment of employer, salary sacrifice and personal deductible (i.e. self employed) contributions and therefore no rationale as to why such deductibility is not permitted.

The $50,000 annual limit on concessional contributions would control the concessions available and there would be no benefit in exceeding the limit as excessive contributions would be taxed at the top marginal tax rate.

Allowing deductibility for personal contributions would benefit those employees whose employers limit or do not provide for salary sacrifice contributions.

Abolishing the 10 per cent rule would create a level playing field whereby all superannuants would have the same access to concessional contributions and the same flexibility to decide whether their voluntary contributions should be made from before or after tax income. The limits on concessional and non-concessional contributions would ensure everyone receives the same tax concessions. Such a move would be another important step in ensuring equity and simplifying the superannuation system.

Recommendation:

Abolish the '10 per cent rule' for the deductibility of superannuation contributions to provide greater incentive and flexibility to people who have to make their own superannuation provisions.

2.2. Taxation of superannuation death benefits

CPA Australia believes the tax treatment of all superannuation death benefits should be consistent for dependants and non-dependants.

The payment of death benefits to dependants after 30 June 2007 are tax free (with the exception of income streams to dependants under age 60), while the taxable component of death benefits paid to non-dependants is taxed at 15 per cent.

This provides arbitrage opportunities. For example, an individual knowing they are going to die will be able to take their superannuation benefit as a lump sum and pass it on to their adult children tax-free. On the other hand, where death is sudden and unforeseen, the benefit may still be paid to the adult children but it would be taxed at 15 per cent.

Strategies are also being promoted in the market to minimise this tax treatment. For example, re-contribution strategies where the taxable component is withdrawn over time and re-contributed as an undeducted contribution, effectively reducing the taxable component to nil. Or separating the taxable and tax-free components into separate superannuation funds with the tax-free component payable to the non-dependant/s on death and the taxable component to the dependants. These strategies create inequities within the system as the people with the knowledge and ability to seek out advice will benefit, while those who need it the most may miss out.

At present, in pension phase the current interpretation of the law by the ATO is that the final payment after the death of a pensioner is being treated as a lump sum. Consequently the interest is in accumulation phase at the time of payment and CGT becomes payable. CPA Australia believes that as the interest was in pension phase, the final payment should be the finalisation of the fund's pension obligations and treated as such.

CPA Australia believes the tax treatment of superannuation death benefits needs to be reviewed in a holistic manner to ensure consistent and equitable treatment of payments to dependants and non-dependants alike. In particular:

- The taxation of all superannuation death benefits should be consistent, i.e. tax free.
- The current inconsistencies between the definitions of 'dependant' in the SIS Act and the *Income Tax Assessment Act 1936* be removed by aligning the definition of 'child' in the ITAA 1936 with that in the SIS Act.
- The appropriateness and utilisation of 'anti-detriment' payments be reconsidered
- The final payment of an income stream upon death to be treated as an income stream payment not a lump sum.

Recommendation:

The tax treatment of superannuation death benefits to be reviewed to ensure consistent and equitable treatment of payments to dependants and non-dependants alike.

2.3. Exclude overseas benefits from contribution limits

CPA Australia believes benefits transferred from overseas superannuation funds should be exempt from the contribution limits. Given these benefits are treated as if they have been accumulated in the Australian superannuation system, i.e. they are taxed accordingly, the individual should have the opportunity to add them to their Australian superannuation benefits. Applying the limits may actually make it difficult, if not impossible, for individuals to transfer their retirement savings into Australia as there will be situations where overseas funds will not permit partial transfers of benefits. As such, the transfer amount should be exempted from the limit on non-concessional contributions and the amount elected to be treated as taxable contributions, i.e. the earnings, should be exempted from the concessional contribution limit.

We understand there may be concerns that such an exemption may provide the opportunity for individuals to funnel contributions through overseas superannuation funds and hence bypass the contribution limits. However, we believe the risk of this is low, due to the difficulties involved with residency, termination of employment, taxation and payment rules, compared to the importance of allowing, and encouraging, expatriates to consolidate their retirement savings in Australia.

This issue was recognised by The Senate Standing Committee on Economics in its inquiry into the simplified superannuation legislation[4], where it recommended that the government consult with the superannuation industry to develop anti-avoidance measures to allow bona fide overseas transfers in excess of the non-concessional contribution cap.

Recommendation:

Introduce measures to enable transfers from overseas superannuation funds to be excluded from the contribution cap limits.

[4] Report on *Tax Laws Amendment (Simplified Superannuation) Bill 2006 [Provisions] and related bills [provisions]*, Senate Standing Committee on Economics, pp 24-25.

Appendix B: extract from CPA Australia pre-budget submission 2009-10

4.2.4 Definition of Australian superannuation fund

Subsection 295-95(4) of the *Income Tax Assessment Act 1997* states that, to avoid doubt, the central management and control of a superannuation fund is ordinarily in Australia at a time even if that central management and control is temporarily outside Australia for a period of not more than 2 years.

The Commissioner of Taxation at paragraph 30 of Draft Taxation Ruling TR 2008/D5 expressed his view that the central management and control of a fund (CM&C) "*will be 'temporarily' outside Australia only if the person or persons who exercise the CM&C of the fund are outside Australia for a relatively short period of time and that the absence must either be defined in advance or related (both in intention and fact) to the fulfilment of a specific, passing purpose."*

The legislation fails to recognise that more Australians who are members of self managed superannuation funds are now being transferred in their employment to foreign countries and that while the individuals would regard the transfer to be 'temporary', the transfer may be for a number of years and could be for an undefined period. Also the absence may initially be defined but often is extended by employer decisions. Although the individuals would retain the intention to return to Australia, pursuant to subsection 295-95(4) the CM&C would not continue to be in Australia.

The legislation also fails to recognise that many Australians seek overseas employment to broaden their employment opportunities or because of the lack of immediate employment in Australia. These Australians usually intend to return to employment in Australia but may not have a definite timeframe for their return.

These Australians therefore are often prevented from continuing their self managed superannuation fund while they are absent from Australia or if they have continued their fund, because their absence ends up longer than 2 years and therefore not 'temporary', their self managed superannuation fund ceases to be a complying fund and tax is imposed on the amount calculated under section 295-325.

To address these issues it is submitted that the reference to an absence of 2 years in subsection 295-95(4) be deleted and be replaced by a reference to the intention of the individual members, which can be established in retrospect.

Recommendation:

Remove the reference to an absence of two years in the definition of Australian superannuation fund in the ITAA 1997.