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AFTS Secretariat
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Summary:

Our submission to Australia's Future Taxation System Review Panel is a proposal that the taxation of all Superannuation Funds be on a progressive basis rather than the current "flat tax" basis so as to provide additional assistance for low income earners, younger workers, single income families and part-time workers.

We believe that such a measure could be introduced on a revenue neutral basis, or at any cost chosen by the Government.

We believe the proposal provides a degree of equity, fairness and consistency in relation to the current manner in which income is taxed.

Finally, we believe the proposal moves some small way to reverse the relatively higher proportionate overall taxes paid by lower income earners arising from the introduction of the GST – itself a flat tax on most items of consumption.

Declaration of "Self Interest":

The two Directors of this company are beneficiaries of a Self-Managed Superannuation Fund established in, and operating since, October 1996. If the taxation of Superannuation Funds was moved to a progressive taxation basis, we would most likely obtain a benefit arising from this change.

Background:

To our knowledge, the current taxation rate of 15% on the contributions to, and earnings within, Superannuation Funds/superannuation accounts has remained unchanged since the

… 2

introduction of compulsory superannuation. An exception has arisen recently from initiatives available to those eligible to take a Transition to Retirement entitlement.

The underlying rationale for the introduction of compulsory superannuation savings was an attempt to alleviate future pressure on the public purse; funds accumulated within the superannuation environment over many years would be able to meet the financial needs of retirees without them having to rely on government funded social security payments and transfers.

A secondary objective was that the introduction of compulsory superannuation savings would increase the level of national savings which at the time were well below rates of saving in most other advanced and developing nations.

The irony of an across-the-board flat taxation rate on superannuation contributions and income is that the superannuation tax paid by lower income recipients makes it even harder for them to accumulate sufficient superannuation savings over their working lifetime to fully self fund their retirement. The impact will be that they're more heavily reliant upon the government funded social security system than they would otherwise have been.

By contrast, higher income recipients, and those in a position to salary-sacrifice to build up substantial superannuation savings, are much less likely to require, or even to qualify for, government funded social security.

The tax on superannuation contributions and superannuation income is also a tax on savings albeit at a fairly low rate. By amending the taxation of superannuation from a flat tax to a progressive tax basis, a further reduction in the tax on savings would be achieved.

Example of an Extreme Outcome:

At its most extreme, an example of the absurdity of the flat tax approach to superannuation concerns a high school student who earns $2,000 per month over an extended summer three month break and no income for the remainder of the taxation year.

The young student pays no Income Tax because his earnings are below the tax free threshold.

However, as compulsory superannuation is payable to him by his employer, say $540, the student, within his superannuation fund, is taxed $81.

This admittedly extreme example highlights the lack of equity, fairness and consistency in the taxation of superannuation as compared to the taxation of income.

This lack of equity, fairness and consistency arise only because the superannuation tax is a flat tax rather than a progressive tax. In the case of an employee earning $6,000 per week rather than $6,000 per annum earned by the hypothetical student, there is a net benefit rather than a disadvantage in the way preserved superannuation savings are taxed vis-à-vis readily available income.

Examples of More Likely Outcomes:

To illustrate the impact of the introduction of a progressive basis to the taxation of superannuation, we constructed very rudimentary financial models to compare the variation in outcomes for superannuants after a 40 year working life.

We assumed no change in the level of compulsory contributions and moderate earning rates and inflation rates over the working lifetime of the superannuant.

Finally, we assumed that the first $6,000 of earnings and contributions in “year one”, suitably indexed each year thereafter, attracted a 0% tax rate. Earnings and contributions over this figure attracted the current level of 15% taxation.

For a relatively low income recipient, which we assumed as earning $30,000 per annum gross in 2009 dollars over their working life, our modeling showed that their accumulated entitlement at age 60 under the progressive taxation basis set out above was some 30% higher than under the current regime.

We also modeled the outcome for a medium income recipient, whom we assumed as earning $50,000 per annum gross in 2009 dollars over their working life, and a high income recipient whom we assumed as earning $100,000 per annum gross in 2009 dollars over their working life.

Our modeling showed that the accumulated entitlement at age 60 under the progressive taxation basis set out above was some 18% higher for the medium income recipient and was almost 9% higher for the high income earner than under the current regime.

Cost of Implementation:

Excluding the impact on the Federal Budget (which is discussed below), the cost of implementing a change in the taxation basis of superannuation from a flat tax basis to a progressive basis does not appear onerous.

For those operating and managing their own Superannuation Funds, the cost would be nil.

For those organizations providing Employer and Industry Superannuation, there would presumably be a cost in adjusting their operating systems and procedures but one would imagine even these costs would be negligible.

Even so, against a one-off cost to revise systems and procedures, the move from a flat tax to a progressive tax basis would, as set out above, result in an increase in the level of funds held within superannuation accounts for lower paid workers. These types of workers are most likely to be the ones whose superannuation is managed by the Employer and Industry Funds. As such, any initial costs incurred by these Funds are likely to be offset by a much higher level of funds under management.

Impact upon the Federal Budget:

In the illustration set out above, where a tax free threshold of $6,000 is established for all superannuation accounts, the cost, all other things being equal, would be up to $900 per annum for each superannuation account holder.

Other than low income earners and part time workers with relatively low superannuation accumulations, or younger workers entering the workforce with only moderate superannuation accumulations, it's not difficult to imagine that, in time, most Australians would benefit by the full $900 per annum.

In terms of a recurring annual budgetary impost, the concept of allowing a tax free threshold of $6,000 for all superannuation accounts would presumably cost more than the Federal Governments April 2009 Tax Bonus initiative.

However, whilst we believe that the principle of introducing a progressive basis to the taxation of superannuation is highly desirable, we do not believe its introduction should necessarily impact upon the Federal Budget.

The information at our disposal to articulate specific quantifiable suggestions is extremely limited and, in any event, the rudimentary financial analysis we could do would lack the rigor required by Federal authorities anyway.

Nonetheless, it is fair to say that the introduction of a progressive taxation basis for superannuation could be accomplished at any cost the Government so chooses, or be done on a revenue neutral basis.

A reduction in the tax free threshold to $3,000 for superannuation accounts would reduce the maximum benefit under the new arrangements to $450 per annum per superannuation account. A variation in the threshold to any other figure would similarly affect the cost.

At the other end of the spectrum, an adjustment of the superannuation tax rate from 15% to 16% or even 17.5% on contributions and earnings above the threshold figure could "claw back" most, if not all, of the cost incurred by establishing a tax free threshold.

Relative Taxation Contributions:

The introduction of GST – itself a flat tax on a wide range of consumption items – has led to an increase in the relative tax contribution made by lower income earners.

This is mitigated to some degree by the various exemptions for basic food items which, somewhat ironically, may even add a degree of progressiveness to the GST.

The proposal to tax superannuation accounts on a progressive basis, so that lower paid workers pay a proportionately lower rate of taxation is certainly not inconstant with the manner in which Income Tax works

… 5

The proposal to tax superannuation accounts on a progressive basis not only supports a consistent approach to the taxation of “earnings” but also goes some way to redress the higher relative tax contributions made by lower paid workers arising from the introduction of GST.

Conclusion:

We believe that AFTS Review should give very serious consideration to the implementation of a progressive taxation basis in relation to the taxation of superannuation.

Our rudimentary analysis suggests that the progressive taxation of superannuation contributions and income will particularly enhance the superannuation accumulation of lower paid workers with a consequent long term benefit of reducing reliance upon social security support.

We believe that the introduction of a progressive taxation basis for superannuation can be achieved on a revenue neutral basis, or at any cost the Government chooses.

Additionally, we believe the introduction of a progressive taxation basis for superannuation provides a more fair, equitable and consistent way of taxing earnings and philosophically brings the taxation of superannuation into line with the taxation of other income earned.

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Should we be able to do so, we would be pleased to assist the Review Committee in any manner we can with respect to clarifying and elaborating upon our suggestion.

Regards,

Geoff Cossar
Director