



29 May 2015

Tax White Paper Task Force
The Treasury
Langton Crescent
PARKES ACT 2600

Email: bettertax@treasury.gov.au

Dear Sir/Madam

Actuaries Institute Submission

The Actuaries Institute welcomes the opportunity to comment on the tax discussion paper released by the Treasurer on 30 March 2015. The Institute represents the actuarial profession in Australia and is a regular contributor to public policy debates which are germane to the profession's areas of expertise. The profession has a strong and influential presence in the field of superannuation and our commentary on the tax discussion paper generally focuses on the tax treatment of savings accumulated in that vehicle.

However, a general point we would emphasise is that superannuation tax arrangements are powerful drivers employed to influence taxpayer behaviour. The Institute has regularly advocated that the retirement income system needs an overarching policy with agreed goals – a conclusion reiterated in the final report of the Financial System Inquiry (recommendation 9). Once those goals are established the efficacy, equity and efficiency of superannuation tax arrangements can be better assessed and adjusted accordingly.

The attached submission provides responses to Q22 posed by the tax discussion paper – “How appropriate are tax arrangements for superannuation in terms of their fairness and complexity? How could they be improved?” There is also some commentary on home equity release, deferred annuities and stamp duty on insurance policies in connection with GST arrangements.

The key conclusions of the paper are:

1. The current concessional aspects of superannuation contributions are unfair, particularly for people earning up to \$37,000. We recommend that the low income superannuation contribution (LISC) be extended beyond 30 June 2017.
2. We suggest that the Division 293 tax be extended to individuals with an adjusted taxable income (ATI) of more than the sum of \$180,000 plus an allowance for superannuation contributions, which would provide a tax concession on superannuation contributions of between 15% and 22% for most people. We also suggest that a lifetime cap be gradually phased in for both concessional and non-concessional contributions.
3. One way to limit the tax concessions provided on investment earnings on assets supporting a superannuation income stream would be to limit the amount of any superannuation benefit that can be “crystallised” and then invested in a superannuation income stream that has a 0% tax on investment earnings. For example, a lifetime cap of say \$2.5 million (indexed to wages, such as MTAW) could be applied. Any excess amount could remain in a superannuation account and 15% tax on investment earnings would continue to apply.
4. We recommend that the tax treatment of investment earnings on deferred lifetime annuities (DLAs) and deferred group self-annuitisation products (GSAs) should also be tax free during that part of the deferral period later than the age 60 when superannuation

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income streams become tax-free (subject to any necessary constraints on access to capital such as commutation and death benefits).

5. Consideration should be given to reintroducing maximum withdrawal factors for income streams, which could be set at double the minimum withdrawal factors, to provide a corridor within which payments would be considered to be an income stream. Apart from some limited exceptions (e.g. funding for aged care, financial hardship), any withdrawals in a financial year above the maximum withdrawal amount would be considered to be a lump sum payment and taxed accordingly.

While not specifically a tax measure, we suggest that the means tests for the age pension be considered as part of this review, given its interaction with superannuation affects the retirement income level of most Australians. This review should include not only the level of the thresholds and the taper rates, but also how different assets are treated for inclusion in (or exclusion from) the means tests.

6. Recognising the high value of the home equity component in retirement savings, consideration should be given to maintaining the means test exemption on a portion of any home equity released on the sale of the family home, or released in some other way using an allowable financial instrument. This would provide an improved standard of living for retirees by utilising their own assets.

In addition to the enclosed submission, we would also direct the Task Force's attention to the set of retirement incomes papers prepared recently by Treasury for industry consultation. The Treasury papers assessed aspects of: revising the annuity and pension rules; purchase options for income streams (including in accumulation phase); and, the minimum drawdown amounts for account based pensions. We believe sensible taxation reform needs to be cognisant of those policy discussions.

The Institute would be happy to discuss these recommendations and others contained in the attached submission or if you believe modelling particular issues would be of benefit your deliberations please contact our CEO David Bell on (02)9239 6106 or via e-mail david.bell@actuaries.asn.au.

Yours sincerely

Estelle Pearson
President



Actuaries Institute: Submission to Tax Discussion Paper, March 2015

1. Tax and limits on superannuation contributions, both concessional and non-concessional; including annual and lifetime caps

People earning up to \$37,000 pa receive little or no tax concessions on their superannuation contributions. Indeed, the 15% contribution tax is actually a penalty for people earning less than the tax free threshold of \$18,200. **We recommend that the low income superannuation contribution (LISC) be extended beyond 30 June 2017.** The LISC is calculated as 15% of the concessional superannuation contributions paid, up to a maximum of \$500. This maximum is equal to the superannuation guarantee (SG) rate that applied when it was first introduced (9%) times \$37,000 times 15%. As the SG rate increases, we also suggest that the maximum LISC be increased as well (e.g. \$530 for an SG rate of 9.5%, and \$670 for an SG rate of 12%).

For people earning between \$37,000 and \$180,000, the current tax concession provided on superannuation contributions is either 17.5% or 22% (this compares with 19% for people earning between \$18,200 and \$37,000 if the LISC continues as above).

With effect from 1 July 2012, Division 293 tax applies in respect of high income earners with an adjusted taxable income (ATI) of more than \$300,000. This tax effectively applies an additional 15% surcharge on high income earners such that the tax concession provided on superannuation contributions is effectively 15%.

The main anomaly that remains seems to be in relation to people earning an ATI between \$180,000 and \$300,000, where the tax concession provided is still at 30%. **We suggest that the Division 293 tax be extended to individuals with an ATI of more than the sum of \$180,000 plus an allowance for mandatory employer superannuation contributions that are included in ATI.** For example, SG contributions on \$180,000 are currently \$17,100 (at 9.5%), or alternatively you could use the concessional contribution cap (e.g. \$35,000 for anyone aged 49 years or over as at 30 June 2014).

This would provide a tax concession on superannuation contributions of between 15% and 22% for most people, which is roughly in line with the Australia's Future Tax System Review's recommendation number 18.

Further, this approach does not represent an entire new system that would potentially have additional administration and transition costs. Any additional costs would be limited given that it represents an incremental change to the current system.

In addition to the current contribution caps, a lifetime cap could be gradually phased in for both concessional and non-concessional contributions to limit how much money can be saved in a concessional environment in future.

One method of introducing lifetime caps would be to permit unused portions of a cap to be rolled over from year to year. For example, if the "basic cap" is \$30,000 and \$20,000 of concessional contributions were made, then the unused portion of \$10,000 could be rolled over into the following year. To encourage earlier contributions, this rollover amount could be halved so the next year's cap would become \$35,000 (that is, the prior year's cap of \$30,000 plus \$5,000).



If the concessional contributions made in the next year were \$15,000, then \$10,000 (that is, half of the unused portion of the prior year's cap of \$35,000) would be added to the following year so that the available cap would then become \$45,000. The ATO would need to keep a record of the available unused portion of past contribution caps.

To limit large one-off concessional contributions, it is also suggested that the maximum concessional contribution in any year is limited to say two times the "basic cap". A similar approach could be applied to non-concessional contributions, with a reduced annual cap applying, subject to any exceptions that may be warranted such as the sale of a small business.

This approach has the advantage of no retrospectivity as it can commence at any time. As it commences with the "basic cap" for the first year, higher contributions would not be permitted in the first year (except as part of any transition rules for members age 49 or over). Over the longer term, it may be appropriate to place a limit on lifetime contributions including both concessional and non-concessional contributions.

As the ATO already monitors the level of concessional and non-concessional contributions, the ATO could inform each taxpayer of the size of their concessional and non-concessional cap for each year. It is recognised that excess concessional contributions are treated as non-concessional contributions.

2. Tax on superannuation investment earnings, in both the pre and post retirement periods

The Henry Review's recommendation number 19 was that the rate of tax on superannuation fund earnings should be halved to 7.5%, and should also apply to capital gains (without a discount) and the earnings from assets supporting superannuation income streams. However, at the time the final report was delivered (1 May 2010), it is worth noting that the tax free threshold for income tax purposes was \$6,000. From 1 July 2012, the tax free threshold increased to \$18,200.

Whereas previously, if an individual's investment earnings on assets supporting a superannuation income stream was at the rate of say 5%, this would mean that the person would not pay any tax on those earnings outside of superannuation until the capital amount exceeded \$120,000. With the tax free threshold now at \$18,200, this amount has increased to \$364,000 (or \$728,000 for a couple).

We would be concerned if a tax on investment earnings on assets supporting a superannuation income stream forced a significant number of retirees out of the regulated superannuation system (where members of APRA regulated funds are treated as wholesale investors) into a regime where individuals will be treated as retail investors and fees and costs are therefore likely to be higher.

Also, could such a change affect the pace at which individuals' access and spend their savings, with a flow-on effect on the cost of the Age Pension? **One way to limit the tax concessions provided on investment earnings on assets supporting a superannuation income stream would be to limit the amount of any superannuation benefit that can be invested in a superannuation income stream. For example, a lifetime cap of say \$2.5 million (indexed to wages, such as MTAW) could be applied.**

Any accrued superannuation taxes would need to be crystallised (i.e. any unrealised capital gains to be realised and tax paid to the ATO) before transferring the money into a superannuation income stream.



ASFA has just released a paper on the small proportion of very high account balances above \$2.5 million (~ 0.5% or 70,000). Any amounts above this \$2.5 million threshold could remain in superannuation and be taxed at 15% on any investment earnings, or be withdrawn (see section 3).

Consideration would need to be given to the transition to such an arrangement and the impact on people expecting to retire in coming years, as well as the impact on defined benefit pensions and annuities.

It is also worth noting that, if the investment earnings tax rate was the same in both the accumulation phase and for a superannuation income stream product, there would be no incentive to transfer into a superannuation income stream product which has to comply with additional rules (such as minimum drawdown) compared to an accumulation product.

Further, with a 0% tax rate on superannuation income stream products, consideration should be given to the treatment of franking credits.

While this may form part of a separate review into retirement income stream products, **we also recommend that the tax treatment of investment earnings on deferred lifetime annuities (DLAs) and deferred group self-annuitisation products (GSAs) should also be tax free during the deferral period (subject to any necessary constraints on access to capital such as commutation and death benefits). For this purpose, the deferred period would commence from the time earnings become tax-free (currently on or after age 60).**

3. Tax on benefits including pensions and superannuation lump sums, not just restricted to bequests

Consideration should be given to reintroducing maximum withdrawal factors for income streams, which could be set at double the minimum withdrawal factors, to provide a corridor within which payments would be considered to be an income stream. Apart from some limited exceptions (e.g. funding for aged care, financial hardship), any withdrawals in a financial year above the maximum withdrawal amount would be considered to be a lump sum payment. A tax free threshold could be set for the taxable component of lump sum payments, targeted mainly at low income earners, of say \$185,000 (indexed to wages, such as MTAW). Lump sum payments above this lifetime threshold (accumulated over time) would be taxed at 15% plus Medicare levy.

On death, if there is a Spouse (or other Dependant), they would likely have planned their retirement together and it is therefore reasonable that the partner has the opportunity to rollover (tax free) the death benefit into a super account/income stream in their own name. Payments to non-dependants would be taxed as a lump sum (i.e. amounts above \$185,000 taxed at 15%, except for non-concessional contributions).

Given the retrospective impact of this change to the tax treatment of lump sums, there should be a reasonable transition period provided to allow people to adjust their planning.

Anti-detriment payments on death benefits were introduced as part of the introduction of the 15% tax on concessional contributions in 1988. These payments add complexity to the system and consideration should be given to the amount of revenue that would be raised by its removal.

4. Accessing home equity for retirement income



For most Australians, the family home is a substantial financial asset, often greater in value than their superannuation savings. In the interest of living a better life in retirement, people should be able to access a certain amount of home equity to top up their superannuation in retirement. Access to home equity could be via a financial instrument (such as a reverse mortgage or equity release scheme) or via a market transaction (such as downsizing to a smaller home). **Consideration should be given to maintaining the means test exemption on any home equity released on the sale of (or in respect of) the family home.** That amount could go into their superannuation fund in a “protected” account that is not included for the assets test (like the family home was treated). The remaining home equity would still be available for health and aged care.

Some additional matters are flagged below. These issues should be included in the proposed Green Paper to facilitate wider discussion amongst interested stakeholders.

5. Stamp duty on insurance products

At the time the GST was introduced, it was intended that stamp duty on insurance policies would be removed. However, the stamp duty was never removed. If the GST is to be amended in any material way, consideration should be given to negotiating with state governments to ensure stamp duty on insurance policies is removed. Removing such friction costs should boost the community's level of insurance cover and reduce reliance on all government safety nets.

6. Other savings taxes

Consideration should be given to removing the pre-85 capital gains tax (CGT) exemption for assets acquired before 20 September 1985, maybe by applying CGT on gains from “today's value”.

7. Negative Gearing

Consideration should also be given to negative gearing of property investments so that investors can only offset the losses against the property's income, not against other sources of income as well.