

3 June 2015

Submission to the Tax White Paper Task Force

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This submission is a response to Question 22 of the March 2015 Tax Discussion Paper

“How appropriate are the tax arrangements for superannuation in terms of their fairness and complexity? How could they be improved?”

SUMMARY OF RECOMMENDATIONS

Recommendation 1: Superannuation funds be required to progressively invest 20% of assets in Australian Infrastructure Bonds.

Recommendation 2: Set the maximum annual amount which can be withdrawn from a superannuation balance at twice the minimum amount. This means a person at age 65 is required to withdraw a minimum pension equal to 5% of their superannuation balance and may withdraw a maximum pension equal to 10% of their superannuation balance.

Recommendation 3: Include the value of the family home above \$1million in the assets test for the Age Pension. Offer people, who if not for the value of their family home, would qualify for the Age Pension income support equivalent to their Age Pension entitlement as a loan to be repaid on the sale of the home or otherwise from their estate.

Recommendation 4: Proceed with the deferred progressive increase in compulsory superannuation contributions to 12%.

Recommendation 5: Prohibit non-concessional superannuation contributions when the superannuation balance exceeds \$2million.

Recommendation 6: Tax earnings on superannuation balances over \$2million in the pension phase the same as superannuation earnings are taxed in the accumulation phase.

DISCUSSION

The Age Pension and Superannuation are the two major components of Australia's retirement income system. Documents viewable on the Treasury

website explain how the retirement system is intended to operate. “The Age Pension provides a basic safety net retirement income, which is not directly linked to income earned over a working life, other than via the social security means tests. The role of the superannuation system is to enable people to build savings, through compulsion and voluntary incentives, that will allow them to achieve a standard of living in retirement above that which the Age Pension alone can provide.”

The Treasury website also gives a statement of objectives:

“the objectives of the Australian superannuation system are to:

Provide an adequate level of retirement income

Relieve pressure on the Age Pension

Increasing national savings, creating a pool of patient capital to be invested as decided by fiduciary trustees.”

Australia’s superannuation system is strongly supported by all political parties. With compulsory superannuation contributions in place for over 20 years how well are Australia’s superannuation arrangements meeting their objectives? The objectives are considered in reverse order to that stated above.

INCREASING NATIONAL SAVINGS, CREATING A POOL OF PATIENT CAPITAL TO BE INVESTED AS DECIDED BY FIDUCIARY TRUSTEES.

Against this objective superannuation has been extremely successful, perhaps overly successful. Superannuation funds have accumulated a pool of savings approaching \$2 trillion and all forecasts predict further substantial growth in future years. Less successful has been the deployment of these savings to the benefit and development of the Australian economy. Many of Australia’s largest superannuation fund managers now invest between a quarter and a third of superannuation balances overseas, partly for diversification and partly as a result of a perceived lack of investment opportunities in Australia. At a time when Australia is in need of substantial investment in infrastructure we have been unable find a mechanism to direct superannuation savings to this purpose.

Recommendation 1: Superannuation funds be required to progressively invest 20% of assets in Australian Infrastructure Bonds.

If phased in over 10 years this would provide a pool of over \$400million to fund infrastructure investment. If the infrastructure bonds paid interest at a rate 2% above the Reserve Bank cash rate superannuation funds would earn a return at least comparable to term deposits and also contribute to the future development and prosperity of Australia. It is a way that superannuation funds could give something back to the economy in return for the substantial taxation concessions received.

The nature of compulsory superannuation is to defer current consumption expenditure and hence reduce GDP. Infrastructure projects funded by infrastructure bonds will offset this impact by increasing investment expenditure and GDP.

RELIEVE PRESSURE ON THE AGE PENSION

According to the recent budget the Age Pension will cost \$44 billion in 2015. After 20 years of compulsory superannuation the Age Pension remains the main source of retirement income for over half retired Australians and 80% of retired Australians receive at least some Age Pension payment and accompanying concessions. The extent to which superannuation has reduced dependence on the Age pension appears limited. The extent, if any, to which superannuation has reduced the cost to Government of funding the Age Pension is unclear. Given the large expenditure on the Age Pension and the cost of superannuation tax concessions to people who go on to receive the Age Pension a cost benefit analysis would seem overdue. Will someone earning say three quarters of average weekly earnings ever accumulate enough through compulsory superannuation to provide retirement income to match the Age Pension?

A major attraction of receiving even a small Age Pension is the concessions which come with the pension, particularly those relating to medical and pharmaceutical expenses. People organise their financial affairs to be eligible for the pension and its concessions. With pension eligibility determined by a person's current assets and income it is very attractive for some retired Australians to spend and run down their savings so as to meet eligibility criteria. This includes spending their accumulated superannuation.

To contain the leakage of superannuation savings away from providing a retirement income stream requires restrictions on the rate at which superannuation savings can be accessed. It is only through controlling access

that superannuation will retain a focus on providing sustainable retirement income and offset some of the demand for the Age Pension. At present a minimum percentage of a person's superannuation balance must be paid annually as a pension. It is proposed that there should also be a maximum percentage that can be paid annually.

Recommendation 2: Set the maximum annual amount which can be withdrawn from a superannuation balance at twice the minimum amount. This means a person at age 65 is required to withdraw a minimum pension equal to 5% of their superannuation balance and may withdraw a maximum pension equal to 10% of their superannuation balance.

A financial strategy used by many Australians is to concentrate their assets in their home. Whilst this strategy is primarily driven by the exemption of the principal residence from capital gains tax it results in increased demand for the Age Pension when people reach retirement age. The family home is excluded from the Age Pension assets test so people can own an extremely valuable home and still have access to the Age Pension. My friends Tom and Beryl have followed this strategy and now have a home valued at over \$2.5million. They also receive a small Age Pension and its accompanying concessions. With their home increasing in value by over half a million dollars during the past two years their strategy has worked well. At the same time they are income poor, and withdrawing their access to the pension would cause some hardship.

Recommendation 3: Include the value of the family home above \$1million in the assets test for the Age Pension. Offer people, who if not for the value of their family home would qualify for the Age Pension, income equivalent to their Age Pension entitlement as a loan to be repaid on the sale of the home or otherwise from their estate.

PROVIDING AN ADEQUATE LEVEL OF RETIREMENT INCOME.

With around 50% of retired Australians receiving the maximum Age Pension and another 30% receiving some income from the Age Pension superannuation is clearly not providing the majority of Australians with adequate retirement income. This is in part a consequence compulsory superannuation only being in place for just over 20 years and somewhat better outcomes will occur as the system matures. However the Australian Government's deferral of increasing compulsory contributions to a level assessed as necessary to generate adequate retirement income means that, unless Government policy is

changed, the Age Pension will remain at the centre of Australia's retirement income system.

Recommendation 4: Proceed with the deferred progressive increase in compulsory superannuation contributions to 12%.

Whilst many people's accumulated superannuation is inadequate others have accumulated amounts grossly in excess of what is required. This outcome has occurred, in most cases, through people contributing in accordance with Government policy of the day. In contrast to Tom and Beryl who invested in their house friends Albert and Jean invested in superannuation. When in 2006 Treasurer Costello allowed non-concessional contributions of up to \$1million they saw an opportunity to provide for their retirement dreams. They were prepared to defer access to their savings in return for the reduced rates of tax levied on superannuation fund earnings. Their strategy has worked well, although the volatility and uncertainty caused by the GFC saw some stressful times. Even so their superannuation balances now exceed \$2million. More than enough for a good retirement.

For people, like Albert and Jean, a large superannuation balance has been a consequence of large non-concessional contributions. In the recent budget the annual limit on such contributions was increased from \$150,000 to \$180,000. If non-concessional contributions are made at the maximum level over many years a superannuation balance in excess of that required to fund provide a retirement income stream is inevitable. Superannuation then becomes a tax shelter.

Recommendation 5: Prohibit non-concessional superannuation contributions when the superannuation balance exceeds \$2million.

Recommendation 6: Tax earnings on superannuation balances over \$2million in the pension phase the same as superannuation earnings are taxed in the accumulation phase.

This change would mean that a person with a superannuation balance of \$3 million would pay tax on one third of superannuation earnings and someone with a balance of \$5 million tax on 60% of earnings.