The White paper: Contribution for discussion.

Discussion question 22. How appropriate are the tax arrangements for superannuation in terms of their fairness and complexity? How could they be improved?

Section 4 in Re:think looks at Savings. It focuses on the taxes and concessions available in super, and the tax planning opportunities that are more available to high income earners. However another option is to focus on the savings that can be placed in super. Is there a cap or cut-off point for contributions?

Superannuation in Australia is an investment structure with tax concessions. There are concessional taxes on earnings and contributions, and no tax on benefits once a person turns 60. There is currently no limit to the amount of savings than can be held in an accumulation super fund. Unfunded funds may still have limits to contributions and should be exempt from this discussion.

Let us look at Dallas. Assume he is 45yo with $100,000 in super and earns $110,000 pa (not including the super guarantee of 9.5%).

If Dallas at 45 can salary sacrifice another $19,500 pa in concessional contributions, plus $15,000 pa in non-concessional contributions, then his super balance at 62 will be $995,039. Assume at 63 that Dallas receives an inheritance and takes advantage of the bring-forward rule to make a non-concessional contribution of $540,000. This brings the balance of his super at 65 to $1,680,000. His own contributions are approx $1.3million.

If he rolls this into an account based pension at 65, and draws down the minimum 5%, he will receive an annual income of $84,000 pa.*

No tax on income.

No tax on earnings in the fund.

No CGT. And he even ends up with a Seniors Health Care card.

The proposed changes in the 2015 Federal Budget to the Government pension asset test taper would not affect Dallas because his assets are already above the current cut-off points for the age pension. His income is also above the ASFA retirement standard for a comfortable lifestyle for singles and couples (currently $42,569 pa for singles and $58,444 pa for couples). ASFA asks the question - how much is enough? We should ask that question about Barry's concessions.

Prior to July 2007 a reasonable benefits limit (RBL) was placed on super account balances. A combination of the RBL and caps on contributions effectively limited the balances in super, and also limited the tax concessions paid out to super funds. When Parliament abolished the RBL and removed the tax on withdrawals for people aged 60 plus, they 'let the genie out of the bottle'. The cost of concessions on employer contributions is set to reach $20.5 billion by 2018/19. The cost of the concession on super fund earnings may rise to $30.4 billion in the same time. This combined amount could overtake the cost of the age pension by 2018/19 (estimated $50.4 billion in 2018/19).

An option is to introduce a lifetime cap on contributions.

This differs from the old RBLs in that the RBL was the maximum amount of money the government allowed you to take in superannuation. There were two different levels in 2006/07:

- $678,149 if you took out your super as a lump sum, and

- $1,396,291 if you drew down on your super as a pension. Any money in excess of the RBL was called the excessive component and incurred tax penalties when taken out – thus putting limits on super balances. The RBLs were abolished in 2007 to relieve super funds from complex reporting requirements, and to remove taxes on end benefits.

A lifetime cap on contributions simply puts a limit on the funds that can be placed into super. Any funds in excess of the cap should be returned to the customer without penalty, unless they are repeat offenders. Any excess concessional contributions can count towards their regular assessable income.

The advantage of the cap on lifetime contributions is the simplicity; we already measure concessional and non-concessional contributions so we are not creating more work. It should not involve complex reporting requirements, and individuals can have a clear goal for their retirement plans.

We can retain the tax concessions relating to the contributions and earnings. These concessions are needed to encourage Australians to set aside funds for their retirement. If we retain the current concessions, then we may not need the other concessions such as:

- splitting concessional contributions,

- the spouse contribution,

- the co-contribution, and

- the current $1.355m concession for the sale of business assets. The exception is the Low Income Super Contribution, as there is a fault under current tax laws affecting the super guarantee contributions for workers earning < $37,000 pa.

If an individual receives contributions into super because they are a nominated or reversionary beneficiary, that should be allowed, but only up to the lifetime cap. Any excess can become part of the estate.

So how high should we set the lifetime cap on contributions? This should be a matter for public discussion.

One option is to use the ASFA retirement standard for singles as a guide. To achieve a comfortable income in retirement it is estimated we need $42,569 pa. At 65 a person commencing an account based pension needs to draw a minimum of 5% of the fund balance. To reach that comfortable standard, an individual would need at least $851,380 in their pension account. This amount would rule a single person out of an age pension due to assets. Under this scenario an individual could lodge up to $851,380in both concessional and non-concessional contributions, and be allowed take adequate advantage of the current tax concessions in super.

Another option is to use the retirement amount of $851,380 as a guide, and work out an estimated amount of contributions needed by an individual (plus fund earnings) that would assist the average worker to reach $851,380 in retirement savings. The current AWOTE is $1,476.30 pw or $76,767pa.

Let us assume that Barry is 45, earning $76,767pa, and has accrued $129,000 in super, of which $75,000 is from the employer contributions made on his behalf. If Barry also salary sacrifices $800 pf, he will have $851,571 in super at 65.*

In addition to the initial contributions of $75,000, in 20 years he has input $123,978 in super guarantee contributions and $353,600 in salary sacrifice (assume less 15% contributions tax); a total of $552,578.

This figure is purely a guide, but if an individual can put together $851,000 in retirement by contributing an average of $552,000 in their lifetime, then $552k could be our lifetime cap on contributions. The final amount may require an actuarial valuation, but once this lifetime cap is calculated, it may only need adjustments each year – either legislated or indexed to CPI. If earnings and compound interest push the fund balance over the lifetime cap limit, then that is acceptable and should be permitted.

What happens to existing individuals who have already exceeded the lifetime cap? They should be allowed to keep their contributions in super. Many individuals made contributions to super in good faith, believing that the rules at the date of contribution would give them a concessional treatment in retirement. An example is the individual who took advantage of the $1m transitional contributions cap before 30 June 2007. Those were the rules at the time and should be honoured. Another exemption should be given to individuals who have their super depleted by a family law split.

A couple of consequences of a lifetime cap on contributions.

1. The compulsory super guarantee may reach a point where it is no longer compulsory. An individual could reach their limit in their 30's, and ceasing the employer contributions may also mean a saving for the employer.

2. We should remove the work test restriction on super contributions for individuals aged 65+. There is no need for the work test if there is a lifetime cap.

Every person in Australia should have the opportunity to set aside enough funds to provide them with a comfortable living in retirement. A lifetime cap on contributions can allow this to happen, while also setting a limit on the concessions available. Even a wealthy individual should be allowed to take adequate advantage of the concessional tax rules inside super. Any funds they hold in excess of the lifetime cap can be invested in asset classes outside super and be subject to the normal tax rules.

A lifetime cap on super contributions can be fair, simple to understand and administer, and significantly improve the budget bottom-line.

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*Money Smart Superannuation calculator

Other statistics come from Treasury calculations and an article on RBLs from Travis Morien.