Committee Secretary
Senate Economics Legislation Committee
PO Box 6100
Parliament House
Canberra ACT 2600

18 November 2016

Dear Committee Members

RE: CEPAR submission letter to the Inquiry into 2016 Superannuation Bills: The (Excess Transfer Balance Tax) Imposition Bill 2016 and Treasury Laws Amendment (Fair and Sustainable Superannuation) Bill 2016

Thank you for your invitation to comment on the above bills.

1. ABOUT CEPAR

The ARC Centre of Excellence in Population Ageing Research (CEPAR) is a collaboration between academia, government and industry, based at the University of New South Wales with teams at the Australian National University and the University of Sydney and global affiliations. It aims to establish Australia as a world leader in the field of population ageing research through a unique combination of high level, cross-disciplinary expertise drawn from Economics, Psychology, Sociology, Epidemiology, Actuarial Science, and Demography.

We made three submissions to the Financial System's Inquiry (FSI) on retirement income streams and superannuation and held discussions on the issue with the FSI and Treasury.[1] The key points in our submissions in the past and the present submission align well with the government's initiatives in this area (which are in themselves partly motivated by the FSI inquiry). This includes defining the purpose of superannuation, and developing a superannuation regime that is flexible, sustainable and fit for purpose, facilitating the conversion of Australians' accumulations into income via appropriate retirement income products.

[1] http://www.cepar.edu.au/media/129955/cepar_submission_to_the_financial_system_inquiry_-__final_final.pdf; http://www.cepar.edu.au/media/134027/cepar_supplementary_submission_to_the_financial_system_inquiry__june12_final.pdf; http://www.cepar.edu.au/media/136460/cepar_submission_number_3_to_the_financial_system_inquiry.pdf

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2. OVERALL COMMENTS ON RATIONALE

Before turning to specifics it is instructive to consider the context, rationale, and previous proposals for Superannuation tax reforms. The Government's current proposed *Superannuation Reform Package* (as announced in the 2016-17 Budget with further changes announced by the Treasurer and Minister for Revenue and Financial Services on 15 September 2016) represents another iteration of tax reforms that commenced in the 1980s, coincident with the wider adoption of Superannuation in Australia.

System design flaws

There are three points at which savings can be taxed: (1) when they are saved (2) when they yield returns; and (3) when they are withdrawn. Unlike most other countries, the Australian system opts to tax super savings when they are contributed and when they yield returns instead of when they are drawn as income in retirement. So, taxes on retirement income are effectively pre-paid. This means we need various complex compensatory measures to make sure the system runs smoothly.

For example, it means that we have to tax contributions less than an individual's working-age marginal tax rate. Some might say that this is to reward people for locking money away, but it's arguably because the marginal tax rate that the person will face in retirement will be lower than when they are working. But the design flaw in Australian Super is that the lower contribution tax is flat-rate, which separates Super taxes from the progressive income tax schedule, allowing tax expenditures to accrue more than proportionally to high income earners. It is this systemic problem that has led to caps on concessionary contributions, the Low income superannuation tax offset, and Division 293 tax.

Trying to treat equally the consumption foregone today with the consumption gained in retirement is the basis for our taxation of investment returns. Taxing returns creates a price distortion between consumption today and consumption tomorrow as well as between super and other assets, such as owner-occupied housing. For this reason, we tax Super returns lightly. But while Super is designed to help people transfer consumption between their working life and their retirement, its purpose is not to transfer consumption to the next generation as inheritance. So it makes sense to cap these tax advantages of Super up to an amount that is required to fund one's own retirement.

A comprehensive solution

The committee's attention should be drawn to proposals by the Henry Tax Review, in 2009[2], which was the most comprehensive solution to these issues. That review's recommendations acknowledged that the pre-paid structure was here to stay but suggested linking contribution taxes with the marginal tax rate via a constant level of concession or rebate (e.g., 15-20%), designed to reflect lower income in retirement. Henry also recommended superannuation

[2] https://taxreview.treasury.gov.au/Content/Content.aspx?doc=html/home.htm

returns tax reductions that resulted in zero-taxes on returns – though a limit for the amount of consumption that could be transferred tax-free in a lifetime was not addressed.

Current proposals as a solution

The current bills are therefore a step in the direction of the comprehensive solution suggested by the Henry review. As such, in the interests of pragmatism, the current proposals should be welcomed. These include:

1. Setting out the purpose of super
2. Transfer balance cap for tax-free investment earnings in retirement phase
3. Concessional superannuation contributions cap
4. Lower division 293 tax threshold
5. Lower non-concessional annual contributions cap
6. Low income superannuation tax offset (LISTO) for low earners
7. Extending concessionary contributions to self-employed people who receive at least 10% of income from employment
8. Unused concessional cap carry-forward from previous five years where accumulation is low
9. Tax offsets for spouse contributions to encourage individuals to make superannuation contributions for their low income spouses
10. Extending earnings tax exemption to deferred income streams (including guaranteed annuities and group self-annuities) and limiting abolishing this for Transition to Retirement Income Streams

Setting out the purpose of super as one that revolves around the provision of retirement income has been the subject of past submissions by CEPAR to the FSI. We support the purpose as proposed by the legislation.

Proposals relating to Division 293 tax and LISTO come some way to linking superannuation contribution tax with the personal income tax schedule.

Proposals regarding the transfer cap, annual concessionary contribution cap, and annual post-tax contribution come some way to limit tax-free inter-temporal transfers to what might be reasonable for retirement.

Proposals relating to unused annual concessionary cap carry-forward, the contribution offset for low-income spouse, and tax exemptions for deferred income streams are likely to help with flexibility of Super. Indeed, the latter has been the subject of other past submissions by CEPAR, including to the Financial System Inquiry.

3. ***Specific comments on current proposals***

While the reforms should be broadly supported there are some questions about the parameters and implementation that the committee should consider.

Level of limits

The rationale for setting caps at specific levels is not clear. This is particularly the case for the general transfer balanced for tax-free super in the pension phase. One question is whether the level of the tax-free cap is appropriate given the length of retirement, current low interest rates, poor and volatile investment growth, and variability in health and aged care expenditure in later life. Still, few people are expected to reach that cap so it will admittedly apply to a small proportion of the population (but see point on indexation below).

Spouse versus individual limits

Since the purpose of Super relates to retirement income it makes sense to consider how that income supports members of a couple. While this has been taken into account with respect to the spouse tax offset, most caps apply to individuals and take no account of spouses. This is the case for contribution caps as well as the transfer cap. On the one hand, treating the individual as the unit of analysis for tax purposes incentivises second earners, on the other it may introduce odd incentives. A couple that wants to transfer more than $1.6m held in one person's name could divorce to double their cap entitlement.

Indexation of limits

Indexation matters, but is inconsistently applied, both in this legislation and elsewhere in our retirement system.

It is unclear why the indexation of some thresholds is based on wages and in the case of others it is based on prices. For example, the annual concessionary cap of $25,000 is to be indexed with in line with average weekly ordinary time earnings (AWOTE) in increments of $2,500. But the general transfer balance cap of $1.6 million is due to be indexed to CPI in $100,000 increments. (The legislation also suggests that indexation will only work to increase caps not to decrease them.)

The purpose of indexation is to provide equitable treatment to all individuals over time and maintain the integrity and desired structure of the system into the future. Yet the effect will be to reduce the value of the transfer cap, in relation to the wages of future generations. More people will be affected as wages grow (and as Super matures). The legislation therefore builds in a decrease to the transfer cap, by stealth. While the outcome may be desirable, if government wishes to achieve a certain lower value of the cap then it should be transparent about its aims and model the projected transition.

Indexation that takes account of changes in standards of living is on top of the indexation that may be necessary as a result of increasing life spans. Few retirement income policies take account of this.

Annual versus lifetime limits

We appreciate that annual limits have been scrapped as part of the political debate over the reforms. However, there is an argument that in the interests of flexibility, consideration is given to broadening catch-up contributions over longer periods of time.

For example, someone contributing for 40 years of their career will be subject to a $25,000 concessionary contributions cap, which is worth $1m in current wage terms. But that assumes a constant level of contributions over a full career. Someone with a 'lumpy' career or who arrives in Australia as an adult migrant should be enabled to catch up over the course of their career rather than over the course of five years as currently proposed. Indeed, more recent migrants tend to have far lower Super accumulations than earlier migrants or those born in Australia.

Innovative income streams

There is a real need to facilitate risk management in retirement through innovative products such as deferred annuities. Current changes address some of the tax issues but are only a small step toward improving access and availability of such products. Resolving the tax issues does not resolve Age Pension asset testing issues.

We therefore refer the committee to the various CEPAR recommendations made to the FSI, which the FSI in turn made to government. For example, one recommendation was that Government should establish a supra-regulatory body or formal arrangement focused on facilitating retirement income product provision, allowing for a concerted effort across responsible agencies that take account of tax as well as prudential regulation and public pensions.

Other

In terms of application of the transfer cap and the proposed credit-debit arrangement, it is unclear what would stop those who make use of Super capital in retirement at a rate faster than the minimum withdrawal rate, allowing them to debit funds from and credit funds into the tax-free account.

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