FINANCIAL SERVICES COUNCIL

The Secretary
Senate Economics Legislation Committee, SG.64
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Minerals Resource Rent Tax Repeal and Other Measures Bill 2013

Dear Secretary

The Financial Services Council (FSC) welcomes the opportunity to make a submission in relation to the *Minerals Resource Rent Tax Repeal and Other Measures Bill 2013* (the Bill).

The FSC represents Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks, private and public trustees. The FSC has over 130 members who are responsible for investing $2 trillion on behalf of more than 11 million Australians.

The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is the fourth largest pool of managed funds in the world. The FSC promotes best practice for the financial services industry by setting mandatory Standards for its members and providing Guidance Notes to assist in operational efficiency.

The FSC recognises that the Government committed prior to the election to repeal the Minerals Resource Rent Tax (MRRT) and to repeal some measures that were intended to be funded by the MRRT, including the Low Income Superannuation Contribution (LISC). The FSC, however, commends the Government's pre-election commitment to increase the Superannuation Guarantee Charge (SGC) to 12 per cent, albeit with the two year delay at 9.25 per cent provided for in the Bill.

In this submission the FSC seeks to raise policy concerns in relation to the repeal of the LISC and the proposed two-year delay in the increase to the SGC. The FSC also seeks to raise implementation issues in relation to the repeal of the LISC.

Low Income Superannuation Contribution

Policy concerns

The LISC effectively compensates individuals for the 15 per cent contributions tax paid by individuals on their superannuation contributions when their adjusted taxable income is less than $37 000 per annum. Were those individuals not compelled to contribute 9.25 per cent of their income to superannuation, they would pay no income tax on the first $18 200 of their income, and 19 per cent tax on the next $18 800 of income, up to the $37 000 threshold.

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It was a long-standing flaw in the superannuation system that low-income earners would pay a higher rate of tax on their compulsory contributions than they would if that money was paid to them as income.

The FSC is concerned that for individuals with incomes less than $37 000 a contributions tax that is higher than the corresponding income tax rate acts as a disincentive for unemployed individuals to seek employment, considering it increases the effective marginal tax rate applying to employment income. In the context of Australia's structural decline in labour force participation and aging population challenges, it is poor policy to implement a tax that would discourage Australia's 706 000 unemployed[1] from seeking employment. Repeal of the LISC will also act as a disincentive for the 3.6 million low income Australian employees who currently benefit from this policy.

The reintroduction of contributions tax for low-income employees is in addition to the $9 billion increase in taxes on superannuation under the previous Government. The repeal of the LISC will exacerbate recently diminished public confidence in the superannuation system.

The tax is also inequitable, and disadvantages those least able to afford the additional tax. Examination of the demographic characteristics of the working population who would be affected by the repeal of the LISC demonstrates that the repeal inequitably impacts young people and women.

The impact of removing the LISC for young people is significant as it undermines the benefits of compounding long-term growth that is central to the superannuation system achieving its goal of reducing reliance on Government retirement benefits. Contributions by young people early in their careers are as important to improving self-sufficiency in retirement as contributions made by mature individuals later in life who have achieved higher incomes.

It is estimated that women are overwhelmingly the largest beneficiary of the LISC. Treasury has estimated that over 2.1 million Australian women will benefit from the LISC by over $500 million in 2013-14. It is widely understood that women currently retire with at least 35 per cent lower superannuation savings than men. The FSC is concerned that the repeal of the LISC will unwind any progress made to close this gender gap.[2]

Due to the impact that the repeal of the LISC would have on workforce participation and the long-term retirement savings of women and younger employees, the FSC recommends that the Government consider policy alternatives to the repeal of the LISC that would secure comparable Budget savings to offset the repeal of the MRRT.

Recommendation: The Government not repeal the LISC and instead 'pause' the policy by amending the date from which fund members can accrue an entitlement to a LISC payment to 1 July 2017 to allow the Budget position to first strengthen.

A pause would secure the same Budget savings in the forward estimates as currently forecast. It would also reduce the recurrent cost of the policy once it is implemented as there will be a decreasing number of employees earning less than $37 000 in future years as wages growth raises incomes over that threshold.

[1] ABS Labour Force Report 6202.0
http://abs.gov.au/AUSSTATS/abs@.nsf/mf/6202.0?opendocument#from-banner=LN
[2] Superannuation Savings Gap for Women at 30 June 2009, Rice Warner Actuaries, March 2010

Implementation issues

Section 7(1) of Schedule 7 provides for the repeal of the LISC is in relation to financial years starting on or after 1 July 2013. This retrospectivity results in repealing the LISC becoming more complex the closer the Bill is passed to 1 July 2014. Serious implementation concerns arise if the repeal Bill is passed after 1 July 2014.

Pre-1 July 2014 repeal

A retrospective repeal of the LISC from 1 July 2013 means that the Bill will affect an individual's entitlement to receive the LISC in relation to the current financial year. LISC payments are processed by superannuation funds and the Australian Taxation Office (ATO) soon after the completion of the financial year, ensuring that an immediate repeal of the LISC will not interfere with the administration of the payments.

Superannuation funds and the ATO, however, prepare member communications, such as product disclosure statements, in advance of the commencement of a financial year. Communications are based on the prevailing law.

Member communications in relation to the current 2013-14 Financial Year state that super fund members are entitled to a LISC payment for that year if their adjusted taxable is less than \$37 000.[3] If the passage of the Bill occurs closer to 1 July 2014 the proposed retrospective repeal of the LISC will increasingly confuse members in relation to the current financial year. It is also increasingly difficult to justify the retrospective repeal of a LISC entitlement the longer a fund member has been accruing that entitlement.

If the Bill is not passed by parliament until closer to 1 July 2014 member communications could also increasingly indicate that fund members are entitled to the LISC for the 2014-15 Financial Year given there would be no law passed to the contrary. The FSC is therefore concerned that the longer the passage of the Bill is delayed the greater the potential confusion that the Bill will cause and the longer this confusion will prevail.

Post-1 July 2014 repeal

If the Bill is not legislated until after 1 July 2014 its implementation in relation to LISC entitlements accrued in the 2013-14 financial year would become seriously problematic as superannuation funds and the ATO continue to be required to comply with the existing legislation until such time as parliament chooses to repeal the LISC.

After 1 July 2014 fund members earning less than \$37 000 will have spent the full year under legislation that prescribes they are entitled to the LISC and will expect payment. It is rare that a Government will choose to retrospectively abolish an entitlement that has been entirely accrued immediately before payment of that entitlement is processed.

Processing of LISC payments in accordance with the current legislation will also commence by superannuation funds and the ATO from 1 July 2014. Whilst the physical payment of the LISC from the ATO to funds will likely occur between September and November in 2014, it will be possible for the ATO to make LISC payments from 1 July 2014, potentially resulting in some individual's receiving a LISC entitlement while others miss out if LISC is repealed from 1 July 2014. In addition, funds will begin to prepare member statements and other information

[3] See, for example, ATO LISC communications as of 23 September 2013:
http://www.ato.gov.au/Individuals/Super/In-detail/Contributions/Low-income-super-contribution/

specific to the member's account from 1 July 2014 and these communications will be based on the prevailing LISC entitlement.

If the LISC were to be repealed after 1 July 2014 super funds may be required to reproduce member statements to replace statements issued with 'old' LISC information at significant expense to the funds and, ultimately, fund members. Retrospectivity will therefore create an unnecessary regulatory burden and red tape in the system for superannuation funds.

Retrospective repeal will also create complexity and risk reputational damage for funds that will be required to manage the expectations of fund members who may expect payment of the LISC for that year. It will directly cause higher call centre volumes and correspondence from fund members, impacting both member satisfaction and business efficiency.

Recommendation: If the Government decides to repeal the LISC, and in the event that a full year's entitlement to the LISC is accrued for the 2013-14 Financial Year, the LISC should not be repealed retrospectively and the Government should amend s7(1) of Schedule 7 to change the effective repeal date to 1 July 2014.

Delay to the increase to the Superannuation Guarantee Charge

The FSC recognises that the Government announced its proposed two-year delay to the rate of increase in the SGC prior to the 2013 election and was elected with that position. The FSC is concerned, however, that the proposed delay undermines the policy rationale underpinning increasing the SGC to 12 per cent to minimise the expected cost of the aging population to the Government.

The proposed delay also adds to the public uncertainty around the security of the superannuation system in the context of ongoing fiscal pressures.

<u>Policy rationale for 12 per cent SGC</u>

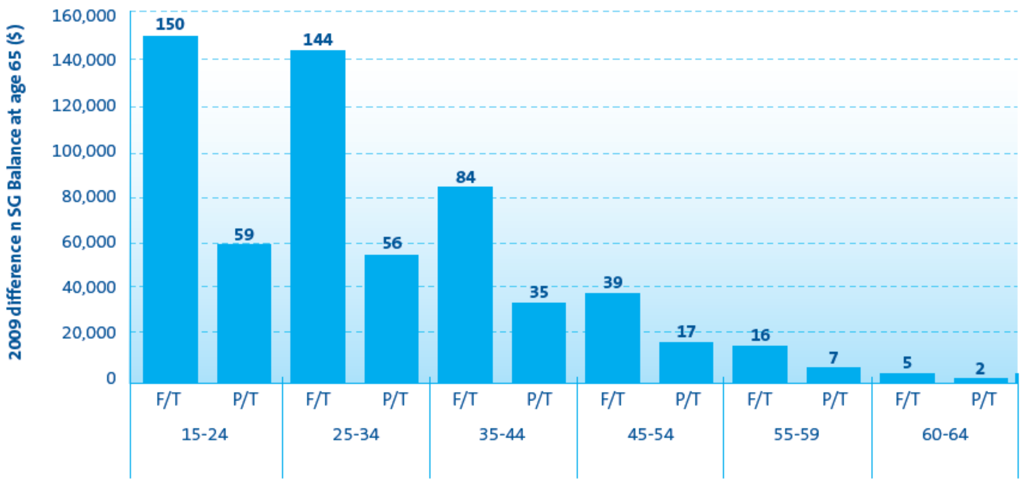
The FSC welcomes the Government's commitment to increase the SGC to 12 per cent. The increase will generate long-term economic benefits and continue to address the national shortfall in retirement savings that is causing Budget challenges for the Government.

Australia currently has a significant 'savings gap,' the difference between the amount required to be saved by the nation as a whole to ensure adequacy in retirement and the amount that will be saved in the superannuation system by the current workforce. Rice Warner Actuaries has determined that under an SGC of 12 per cent the savings gap is over $1 trillion when you take into account those who will live longer than life expectancy.[4]

A University of Canberra NATSEM Report modelled the importance of an increase in the SGC rate to 12 per cent to address the gap by growing individual account balances as shown in Table 1 below.

[4] *Longevity Savings Gap Research and Policy Options*, Rice Warner Actuaries, September 2012

Table 1 - projected difference in super balance at age 65 by age group and labour force status[5]



Note: The values shown are the projected difference between SG contributions of 12% and 9% per annum until age 65. The projections assume real wages growth of 1% per annum and real superannuation returns of 4% pa.

Source: *NATSEM estimates based on HILDA data.*

Increasing the SGC to 12 per cent achieves a long-term benefit for younger working Australians. Employees aged 15 to 24 will benefit from the increase in the SGC to 12 per cent by the reform adding $150 000 to their retirement savings by age 65. NATSEM concluded that “clearly an additional $150 000 in superannuation will make a major difference to a person’s standard of living in retirement and help reduce the fiscal pressure on future governments.”[6]

Impact of two-year delay in SGC rate increase

The proposed two-year delay in the scheduled increase in the SGC, however, undermines the effectiveness of the increase. For those who are likely to retire over the next decade, the delay detracts from the forecast $39 000 increase in individual retirement savings that they would otherwise have accrued.

Significantly, the proposed delay to the phasing in of the Super Guarantee to 12 per cent will result in a cumulative impact of around $40 billion less in super savings in the system over the next seven years.

The FSC strongly recommends that there be no further delays to the increase in the SGC to avoid exacerbating inter-generational pressure on public finances resulting from demographic change in Australia’s population.

The Treasury projections outlined in the 2010 Intergenerational Report (IGR) unequivocally demonstrated how the ageing of Australia’s population will pressure public finances. The IGR concluded that[7]:

- the ratio of working aged people relative to retired people will halve, from around 5 today to 2.7 by 2050;
- between 2010 and 2050, the proportion of Australians aged 65-84 will double, whilst the proportion of people aged 85 and over will quadruple; and
- the proportion of Australians of working age will fall by seven percentage points to 60 per cent of the total populace in 2050.

[5] NATSEM Report, Saving Tomorrow April 2010
[6] NATSEM Report, Saving Tomorrow April 2010 at 24
[7] The 2010 Intergenerational report, The Treasury - http://www.treasury.gov.au/igr/igr2010/

These demographic changes will generate the problem of a shrinking tax base compounded by increased spending on health and pension costs. Health costs will almost double by 2050 to 27 per cent of GDP while pension costs are expected to rise from 2.7 per cent to 3.9 per cent of GDP over the next 40 years.

Any shortfall in retirement savings arising from the delayed increase in the SGC increases the number of retirees who will receive the age pension, and increase the amount of age pension they will be paid over their retirement. It will therefore accentuate the impact of the aging population on the Government and future tax payers.

SGC impact on the economy

There is no evidence to support the proposition that the increase to the SGC is a tax on business or negative for business generally. The implementation schedule was specifically designed to allow employers to take the increased SGC contributions into account when negotiating future wage settlements, ensuring that the incidence will largely fall on individuals.

The experience following the introduction of the SGC and during the increase to 9 per cent shows that business conditions in Australia actually improved significantly:

- Profits as a share of GDP increased during this period, growing from around 6 per cent of GDP in the early 1990s to around 8 per cent in the early 2000s.
- At the same time, productivity rose as real unit labour costs fell.
  - The decline in real unit labour costs was particularly pronounced between 1998 and 2003 when the SG rose from 6 to 9 per cent.
- The unemployment rate declined steadily to its lowest level in decades.

There is also a significant positive impact on the economy of increasing the pool of national savings. Superannuation stabilised the Australian economy during the financial crisis by providing a domestic pool of funds on which Australian businesses were able to draw.

It is estimated that Australia accounted for $90 billion or 10 per cent of the world's total recapitalisation in 2009 allowing Australian businesses to be less reliant on the vagaries of international credit markets.

Recommendation: The Government fully implement the committed increase in the SGC to 12 per cent by 1 July 2021 in order to minimise the negative impacts of the delay on employee's retirement savings and the economy.

Please feel free to contact me on 02 8235 2566 if you have any further questions or comments in relation to this submission.

Yours sincerely

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