AIST submission

Response to Senate Economics Legislation Committee Inquiry: Minerals Resource Rent Tax Bill 2011 and related bills

December 2011

Australian Institute of Superannuation Trustees

Background

On 10 November 2011, the Senate jointly referred to the Economic Legislation Committee for inquiry and report, the following bills:

- the *Minerals Resource Rent Tax (Consequential Amendments and Transitional Provisions) Bill 2011* and;
- the *Minerals Resource Rent Tax (Imposition-Customs) Bill 2011* and;
- the *Minerals Resource Rent Tax (Imposition-Excise) Bill 2011* and;
- the *Minerals Resource Rent Tax (Imposition-General) Bill 2011* and;
- the *Minerals Resource Rent Tax Bill 2011* and;
- the *Petroleum Resource Rent Tax (Imposition-Customs) Bill 2011* and;
- the *Petroleum Resource Rent Tax (Imposition-Excise) Bill 2011* and;
- the *Petroleum Resource Rent Tax (Imposition-General) Bill 2011* and;
- the *Petroleum Resource Rent Tax Assessment Amendment Bill 2011* and;
- the *Superannuation Guarantee (Administration) Amendment Bill 2011* and;
- the *Tax Laws Amendment (Stronger, Fairer, Simpler and Other Measures) Bill 2011*

The Australian Institute of Superannuation Trustees (AIST) submission will focus on the last two bills that cover the provision for:

- An increase in the age of an employee at which the Superannuation Guarantee (a mandatory employer contribution to an employee's superannuation fund that is a fixed percentage of the employee's ordinary time earnings) no longer needs to be provided from 70 to 75, and;
- An increase in the rate of employer contributions from the current rate of 9 per cent to 9.25 per cent in 2013–14, and then incremental increases in each subsequent year to 12 per cent in 2019–20, and;
- The payment of the tax paid on superannuation contributions for employees with an income of less than $37,000 per year into the employee's superannuation fun, up to a maximum of $500.

The implementation of the changes proposed by this Bill are dependent on the passage of the Minerals Resource Rent Tax bills, with the provisions not coming into effect unless the four bills that relate to the proposed Minerals Resource Rent Tax have commenced before 1 July 2013.

On introduction of the bills, the Minister for Financial Services and Superannuation indicated that the Government intended to abolish the maximum age limit for which Superannuation Guarantee contributions were required. This would be provided for in Government amendments to the *Superannuation Guarantee (Administration) Amendment Bill 2011* ("the SGAA Bill").

AIST

The Australian Institute of Superannuation Trustees (AIST) is an independent, not-for-profit professional body whose mission is to protect the interests of Australia's $450 billion not-for-profit superannuation sector. AIST's members are the trustee directors and staff of industry, corporate and public-sector superannuation funds, who manage the superannuation accounts of two-thirds of the Australian workforce.

AIST is a registered training organisation and has recently expanded its education program to encompass the growing and changing needs of all members of the not-for-profit superannuation sector.

AIST offers a range of services including compliance and consulting services, events - both national and international - as well as member support. AIST also advocates on behalf of its members to relevant stakeholders.

AIST's services are designed to support members in their endeavour to improve the superannuation system and build a better retirement for all Australians.

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1 Executive Summary

This submission is solely focussed on the components of these bills that relate to superannuation. Whilst AIST recognises that the changes involve the concessional tax environment of Australia's superannuation system and therefore, require the government to finance additional savings, this submission will not address these parts of the bills.

AIST strongly supports the intent of the superannuation reforms to be implemented by these bills. With respect to the features proposed in these bills, we make the following recommendations:

- AIST strongly supports Australia's existing three-pillar retirement policy; however, we note that current policy settings will leave approximately 80 per cent of retirees wholly or partially reliant on the age pension. We believe this to be unacceptable long-term policy.
- AIST supports efforts to increase Australia's accumulated retirement savings and for this reason, supports increasing the superannuation guarantee to 12%. AIST's paper, *The benefits of an SG rate of 12%,* details how an increased superannuation guarantee will assist in improving this situation.
- AIST's position is further reinforced by research from the Henry Review, Australian Bureau of Statistics (ABS), National Bureau of Economic Research (NBER) and Australian Centre for Financial Studies (ACFS) as well as public polling. In particular, we cite the considerable disadvantage faced by women as a result of insufficient retirement savings and welcome efforts to improve this.
- We support the abolition of the SG age limit. This was a discriminatory and arbitrary cutoff which disadvantaged older Australians.
- AIST strongly supports the policy intent of the Low Income Earners Government Superannuation contribution and believes that it is more relevant, now, with the proposed tripling of the tax-free threshold.

2 Introduction

AIST strongly supports Australia's three-pillar retirement income policy, which is based on shared responsibility between individuals, employers and the Government. However, to ensure that all Australians have enough saved for an adequate retirement, we believe the system requires refinement and reform.

Whilst we recognise that governments must take current financial conditions into account when implementing reform, we also note that strategic vision is vital to ensure Australia is well-placed to deal with the challenges of a rapidly-ageing population and to deliver a dignified retirement to all Australians.

According to the latest intergenerational report[1], current policy settings will leave approximately 80 per cent of retirees wholly or partially reliant on the age pension – even under a fully-matured system. We believe this is unacceptable long-term policy and highlights that accumulated retirement savings are generally insufficient to meet the needs of retirees. To provide an adequate and ideally comfortable retirement, increased levels of self provision are required. A lift in compulsory superannuation savings is necessary to achieve this.

For this reason, we support the Government's decision to provide an additional contribution of three per cent of salary, effectively increasing the compulsory rate of superannuation contributions from nine per cent to 12 per cent.

As noted in the *Bills Digest No 77, 2011-12*[2], at the time that compulsory superannuation was introduced it was envisaged that superannuation contributions of 15 per cent would be necessary to fund an adequate retirement. The planned increases, however, were unfortunately halted at nine per cent and, in many ways, the Australian community is still playing catch up: the proposed increase to 12 per cent still falls inside this original target.

It is widely acknowledged that the issue of equity needs to be addressed when lifting compulsory superannuation. The Low Income Earners Government Super Contribution – a payment of up to $500 a year for individuals on incomes of up to $37,000 – is therefore an important component in the Government's reform proposals. This will result in a more equitable system, particularly for an estimated 3.5 million Australians (with women being 60 per cent of the recipients) by effectively returning all of the 15 per cent tax payable on SG contributions for nearly one quarter of the workforce. A super saving of $830 million is estimated for 2012-13.

[1] Available in parts or in full at http://www.treasury.gov.au/igr/igr2010/ .

[2] Bills Digest No 77, 2011-12, Superannuation Guarantee (Administration) Amendment Bill 2011, Swoboda, 18 November 2011, p8.

3 Increase in the Superannuation Guarantee

3.1 The benefits of an SG rate of 12%

AIST prepared a briefing paper in November 2010, *The benefits of an SG rate of 12%*,[3] which analysed the impact of the proposed increase to 12 per cent SG on workforce participation, career breaks, employers and employees. In summary, the paper finds:

- An SG rate of nine per cent will not deliver sufficient retirement income for most Australians, according to widely-used measures of adequacy;
- Workforce participation rates in Australia suggest a story of the 'haves' and 'have-nots' in terms of ability to accrue an adequate level of superannuation savings***;***
- Increasing the SG rate to 12 per cent would be particularly beneficial for women and other part-time workers;
- As the costs of an ageing population continue to escalate, AIST believes it is critical that we raise the SG rate to a minimum of 12 per cent to ensure that our nation is less vulnerable to a blowout in age pension costs, and our individual retirement savings last longer;
- The SG increase will help alleviate longevity risk associated with insufficient superannuation savings, and the pressure likely to be imposed on the Age Pension through a rapidly ageing population;
- AIST estimated (in today's dollars) that:
  - In 2019-20, the first year with an SG rate of 12 per cent, an additional $24.7 billion will be delivered into Australian superannuation accounts;
  - Total additional superannuation savings due to the rise in the SG rate for all years from 2013-14 (the initial SG rate increase to 9.25 per cent) to 2049-50 will deliver an additional $1.22 trillion into accounts;
  - If this additional $1.22 trillion of superannuation was used in lieu of the forecasted government spending on age and service pensions, it would cover 38 per cent of the $3.23 trillion of age and service pension payments to individuals from 2009-10 to 2049-50 as forecasted in the Intergenerational Report 2010 ("IGR 2010");[4]
  - An SG rate of 12 per cent would make significant inroads into relieving pressure on the government's long-term fiscal gap. However over the next 40 years, payments from the government for its total expected age and service pension liabilities would still exceed the additional savings in superannuation by an average of $49 billion per year. These estimates rely on a number of assumptions and projections from the IGR 2010;[5]

[3] Available from: http://tinyurl.com/8y5xayn
[4] Table A4 of the IGR 2010 projects government spending of $1,570 per person on age and service pension payments for a national population of 22.2 million people in 2009-10, $1,930 per person for 25.7 million people in 2019-20, and so forth, rising to $3,890 per person for 35.9 million people in 2049-50. The sum of all years from 2009-10 to 2049-50 (using linear interpolation for years excluded from Table A4) equals $3.226 trillion.
[5] Op. Cit.

9%	11.72 million	Nil	$35 billion
12%	13.54 million	$84 billion	$465 billion
12%	15.02 million	$371 billion	$1,088 billion
12%	16.63 million	$743 billion	$1,989 billion
12%	18.00 million	$1,219 billion	$3,226 billion

- Annual price inflation, measured from growth in the Consumer Price Index (CPI), has averaged 2.77 per cent since 1994, while annual wage inflation, measured from growth in average weekly ordinary time earnings (AWOTE), has grown at 4.56 per cent. In other words, 'real' wages have grown annually by 1.74 per cent for more than 15 years. If this scenario is repeated in the next decade, employees absorbing the full impact of the SG rate increase up until 2019 would still experience real wage rises of more than one per cent per year.

3.2 The Henry Tax Review

The paper also compared the proposals recommended in the Henry Tax Review.[6] Its key recommendations concerning adequacy of retirement incomes included:

- Removing contributions tax and income tests for income support, and instead taxing employer contributions at marginal personal income tax rates and providing a 20 per cent tax offset;
- Halving the 15 per cent tax rate on super fund earnings to 7.5 per cent, however this new rate would be introduced to earnings from income streams in the retirement phase;
- Developing a private longevity insurance market; and
- Removing the restriction on superannuation contributions for those aged over 75.

Henry's recommendations for the SG rate to remain at nine per cent assume that net contributions under the above tax proposal would be similar to those achieved by a straightforward lift in the SG to 12 per cent. This would be due to the removal of the current 15 per cent contribution tax and the introduction of refundable flat rate tax offset which would mean that only higher income workers would pay more than 15 per cent tax.

[6] *AFTS (Australia's Future Tax System) Report*, known as the 'Henry Tax Review'

The Henry review considered whether to increase the SG rate to 12 per cent, yet recommended that nine per cent was sufficient, although only if the package was accepted in its entirety. Moreover, our modeling indicates that a majority of taxpayers would have less super and experience a significant drop in take home pay under the Henry review recommendations, compared with the Government's super reform package and the Low Income Earners' Superannuation Contribution.

As noted in *Bills Digest No 77, 2011-12*[7], one of the key arguments made for the need to lift the SG rate is that on current projections, most retirees will not be able to sustain a comfortable lifestyle and superannuation savings will run out too early.

3.3 *ABS 6238.0 – Retirement and Retirement Intentions, Australia, July 2010 to June 2011*

The recently released *ABS 6238.0 – Retirement and Retirement Intentions, Australia, July 2010 to June 2011*[8] paper presents some confronting information about retirees' fundamental understanding of the superannuation system and how superannuation interacts with the pension system. It also points to misplaced faith about the capacity of their superannuation savings to provide an adequate income in retirement.

Main sources of Income for those retired	Men	Women
Government pension/allowance	53%	39%
Superannuation/annuity/allocated pension	27%	13%
No personal income	8%	39%
Did not know	6%	1%

Just under half (44%) of women reported 'partner's income' as their main source of funds for meeting living costs at retirement.

As expected, for many people their main source of personal income during retirement changed from superannuation at the beginning of retirement, with more people becoming reliant on a 'government pension/allowance' as they age. This is a natural occurrence as people draw down their superannuation savings to supplement the Age Pension. Furthermore, the paper shows that there is an increase of 46% in the number of people who stated that 'government pension/allowance' was their main source of current income as compared to at retirement.

Of greatest concern is that just over half (53%) of the 3.9 million people aged 45 years and over who indicated that they intend to retire from the labour force reported their main expected source of personal income at retirement as 'superannuation or annuity'. The next most commonly reported main expected source of personal income was a 'government pension/allowance' (26%). It is interesting to note that 7% of people aged 45 years and over who intended to retire did not know what their main expected source of income at retirement would be.

[7] *Op. Cit.*
[8] Australian Bureau of Statistics (ABS), *Retirement and Retirement Intentions*, July 2010 – June 2011, ABS CAT no 6238.0

There were some notable differences reported by those who had already retired compared to those who intended to retire regarding their main (expected) source of personal income at retirement. While 45% of people aged 45 years and over who had retired reported a 'government pension or allowance' as their main source of income at retirement, only 26% of people aged 45 years and over who were intending to retire indicated that this would be their main expected source of income at retirement.

Although 'superannuation or annuity' was reported as their main source of income at retirement by just 19% of retirees, more than half of those who intended to retire (53%)expected that this would be their main source of income at retirement. Similar differences emerged for main (expected) source of funds for meeting living costs at retirement. While only 10% of those intending to retire expected to rely on 'partner's income', this was reported as the main source of funds for meeting living costs by 28% of retirees.

The general message stemming from this ABS paper is that a large proportion of people aged over 45 have an unrealistic expectation of the level of retirement income they can expect to live on, particularly when you consider the average superannuation balance is $89,100, accounting for only 14% of average household assets[9]. Without the current compulsory SG rate over the past 20 years, retiring people would have an even lower level of retirement income and probably an even lower level of engagement. Lifting the SG rate to 12 per cent will allow the ‘disengaged‘ to save more money for retirement, almost despite themselves, and permit greater comfort on retirement and a lower burden on government.

3.4 NBER Working paper No 16740

The NBER Working paper No 16740, *How Financial literacy and impatience shape retirement wealth and Investment behaviours* by Hastings & Mitchell[10] outlines two competing explanations for why consumers have trouble with financial decisions:

1. People are financially illiterate since they lack understanding of simple economic concepts and cannot carry out computations such as computing compound interest, which could cause them to make suboptimal financial decisions; and
2. Impatience or present-bias might explain suboptimal financial decisions. That is, some people persistently choose immediate gratification instead of taking advantage of larger long-term payoffs.

Their results show that impatience is a strong predictor of wealth, while financial literacy is a weaker predictor.

A Chilean based study investigates whether people subject to impatience -- that is, those who overweight current consumption versus the future – are also those who make myopic investment decisions.

[9] Australian Bureau of Statistics (ABS), *Household wealth and wealth distribution*, ABS CAT no 6554.0, 2009-10
[10] http://www.nber.org/papers/w16740

Each participant was offered a choice:

Option	Result
Now	Immediately receive a 5,000 peso gift card
Later	Fill out the questionnaire and mail it back in a pre-paid, addressed envelope within four weeks – at which time the gift card is activated with a higher amount. This higher amount was randomized between 6,000-8,000 pesos in 500 peso increments, so respondents who delayed would receive a 20-60 percent return if they delayed receipt (by up to four weeks).

The experiment permitted identification of three different types of respondents:

Type	Action
Impatient	Took the lower gift-card amount immediately
Efficacious deferrer	Chose the later amount and returned the survey for the higher amount
Inefficacious deferrer	Opted for the later higher amount but then failed to send in the questionnaire so as to activate their cards

This provides a real-world decision measure of ability to delay current gratification for future gains, as well as evidence on peoples' ability to follow through on a plan with financial implications.

Type	Result
Impatient	54%
Efficacious deferrer	30%
Inefficacious deferrer	17%

Therefore, only 30% of the study population actively saved for the future, with 54% taking the money now and 17% being so disengaged they missed out on the money altogether. This pattern of behaviour reinforces the need for a compulsory savings system. Arguably, if the SG was not mandated then only 30% of people would save for retirement. In order to reach the desired levels of adequacy, an increase in the SG rate will help achieve this goal through forced savings.

3.5 *12%: What's it worth?*

AIST recently engaged the Australian Centre for Financial Studies (ACFS)[11] to analyse the benefits of 12 per cent in three simulations to examine the net benefit to individuals in different circumstances with particular focus on the *replacement rate* - that is, retirement income relative to pre-retirement income. First, we test the impact on a new entrant to the workforce aged 20, second a couple where one member is absent from the workforce for ten years to raise children, and finally two older workers at ages 40 and 50 with limited superannuation savings.

[11] AIST/ACFS submission to October Tax Forum, *12%: What's it Worth?* October 2011, http://www.aist.asn.au/policy-research/research/2011-research.aspx

The impact of the increase in SG rate from nine to 12 per cent on the superannuation balance can be summarised as follows:

Scenario	Under 9%		Under 12%		Increase
	Balance	Replacement ratio	Balance	Replacement ratio	
Younger worker - 20yo	$636,296	57%	$877,317	79%	38%
Couple, with career break	$559,055	50%	$770,873	70%	38%
Older Worker - 40yo	$417,347	38%	$535,734	48%	28%
Older Worker - 50yo	$270,029	24%	$337,132	30%	25%

Consequently in all three cases, the increase in SG rate from nine to 12 per cent leads to a significant improvement in the standard of living post-retirement. Both the young worker entering the workforce at 20 and the couple facing life on a one salary for a period of 10 years would expect to see an increase in retirement savings of around 40 per cent. Older workers closer to retirement have less benefit, but would expect to find an increase of around 25 per cent in retirement savings.

Budgetary estimates indicate the cost of this phased implementation at $3.6 billion[12], or around $0.3 billion for each 0.25 basis point increase in the SGC. Figures of this magnitude, when viewed in the context of the overall budget position should not be seen as impediments to the change if the long run consequences of higher retirement savings balances are favourable.

[12] http://www.aph.gov.au/budget/2010-11/content/bp2/html/bp2_revenue-06.htm Those budget estimates appear not to include the consequences for tax revenues of the increased balances in superannuation funds which are subject to concessional tax, although the magnitude of any such effect depends on a range of assumptions including the extent to which super contributions lead to increased aggregate savings.

3.6 Results of public polling

An AIST-commissioned CoreData poll in March 2010 suggested the majority of workers were supportive of the increase, with 61% of respondents indicating they would be willing to pay for the additional three per cent from their wages.

AIST's Essential media poll, conducted in late October 2010 across more than 1000 respondents:

- 70% of all Australians support an increase in SG to 12 per cent, with approval among Liberal and National Party voters at 69%;
- 38% of Australians say their super savings are less than $30,000;
- 54% describe their retirement savings as not sufficient to retire comfortably (In the case of women, this figure is 59%);
- 61% of Australians support revenue from the Minerals Resources Rent Tax being used to fund an increase in the SG;
- Only 11% of women (compared to 17% of men and 14% of men and women) said they had sufficient retirement savings to maintain their current quality of life;
- 59% of women said their retirement savings were not sufficient to "retire comfortably". This figure was the same for those women aged 35-54 and women aged 55 plus - ie despite having the benefits of compulsory super for longer, younger women aren't much more confident about having enough to retire on. Even among those who were very young - aged 18-34 - half, or 50%, described their retirement savings as not sufficient to retire comfortably on;
- Support for super increase to 12% was only slightly varied across income levels, except for low income earners :
    - those on incomes of less than $600pw 61%
    - incomes of $600 to $1000pw 68%
    - Income of $1000-$1600pw 79%
    - income $1600 plus pw 76%
    - and total support 70%

4 Abolition of the SG age limit

AIST supports the abolition of the age limit of an employee at which the Superannuation Guarantee (a mandatory employer contribution to an employee's superannuation fund that is a fixed percentage of the employee's ordinary time earnings) no longer needs to be provided.

AIST believes this is an ageist policy, the removal of which will assist in encouraging older Australians back into the workforce and help improve our productivity. There are many other benefits attached to attracting older workers, including individual health (physically and mentally), and employer benefits (lower staff turnover, in depth knowledge). National Seniors Australia, Productive Ageing Centre, 2009 states 'there are nearly two million older Australians (aged 55 and over) outside the workforce who are willing to work , could be encouraged to work , or are employed and looking for work. Not using the skills and experience of older Australians costs the Australian economy $10.8 billion pa'.

A recent paper, *Ageing and the barriers to labour force participation in Australia* by the Consultative Forum on Mature Age Participation, lists 14 barriers to mature age employment. Superannuation ranked equal eighth at 71.4% as a high/very high barrier. Abolition of the age limit will complement other Government policy measures aimed at retaining older people in the workforce.

5 Low Income Earners Government Superannuation Contribution

AIST strongly supports the policy intent of the Low Income Earners Government Superannuation Contribution and feels it is now even more relevant after the recent government proposal of tripling the tax-free threshold. AIST made a submission to the Low Income Earners Government Superannuation Contribution consultation paper in July 2011.[13]

AIST believes that the payment should be directly linked to the respective rates used in the calculation of the $500 maximum amount payable. We have proposed a formulaic solution so the amount payable does not lose relevance or re-introduces tax inequity if these rates change in the future.

AIST is concerned that the payment may be de-coupled from any future changes in either the lowest marginal tax rate (presently 15 per cent) or the superannuation guarantee (currently 9 per cent but progressively increasing to 12 per cent by 2019). The net result is that pockets of taxation inequity within the system will form as a result of bracket creep. To ensure that de-coupling does not occur, we propose the amount payable be set by a formula which is linked to the following rates: marginal tax rate and the upper income threshold of the income bracket subject to the lowest marginal tax rate; concessional superannuation contribution tax rate; and superannuation guarantee rate as follows, where one's marginal tax rate is on the lowest level (currently 15 per cent):

$$\boldsymbol{A} = (\boldsymbol{B} \times \boldsymbol{C}) \times \boldsymbol{D}$$

Where:

A	=	Maximum low income earners' contribution amount payable ($)
B	=	Upper threshold of taxable income assessable at lowest marginal tax rate ($)
C	=	Superannuation guarantee rate
D	=	Concessional superannuation contribution tax rate

AIST believes such a link will remove any perceived need for indexation and ensure that bracket creep does not impact this payment.

AIST acknowledges the Government has amended the Bill from the Exposure Draft with regard to taxpayers no longer being required to lodge a tax return to receive the payment. This original requirement was in direct conflict with an outcome of increasing the tax free threshold through the *Clean Energy Future* plan to increase the number of taxpayers needing to submit a tax return. The result is an excellent outcome.

[13] Australian Institute of Superannuation Trustees (AIST), Treasury submission, Low Income Earners Government Superannuation contribution, July 2011, http://www.aist.asn.au/policy-research/submissions/2011-collection.aspx