National Foundation for Australian Women

REAL WOMEN. VISIONARY LEADERSHIP

Submission to the Senate Economics Committee Inquiry into

Superannuation (Excess Transfer Balance Tax) Imposition Bill 2016 [Provisions] and

Treasury Laws Amendment (Fair and Sustainable Superannuation) Bill 2016 [Provisions]

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By authority of the NFAW Social Policy Committee

The National Foundation for Australian Women is dedicated to promoting and protecting the interests of Australian women, including intellectual, cultural, political, social, economic, legal, industrial and domestic spheres, and ensuring that the aims and ideals of the women's movement and its collective wisdom are handed on to new generations of women.

NFAW is a feminist organisation, independent of party politics and working in partnership with other women's organisations, including the National Women's Alliances Equality Rights Alliance and economic Security 4 Women. These organisations include those committed to increasing support for women in Australia as well as those with a special interest in women's history.

NFAW has a track record of making submissions to inquiries that relate to the economic effect of policies on women, including Parliamentary Committee and Productivity Commission inquiries.

This document is based on work done by members of the Social Policy Committee in submissions to those inquiries, and in the Gender Budget document that has been prepared in response to the Federal Budget

A Fair Superannuation System

The current superannuation system, which is based on lifetime earnings, provides much greater tax benefits to those with the capacity to contribute more during their working life and high balances to support tax free pensions in retirement. Since 2007 the system of contributions caps, combined with tax concessions and exemptions to superannuation funds and tax free income streams, has allowed wealthy Australians to obtain tax savings through superannuation contributions.

Although the policy is to alleviate financial pressure by encouraging retirement savings to supplement the Age Pension, the tax concessions are skewed heavily towards the wealthy who are not likely to be eligible for the Age Pension, and would invest in alternative retirement savings strategies if the superannuation concessions were not available.

Accordingly the tax concessions need to be rebalanced to provide support to low and middle income Australians saving for retirement.

The data show that women's superannuation balances are consistently lower than men in the same age group. In 2011-12 the average superannuation balance for women aged 60 to 64 was $104,734 compared to $197,054 for men in the same age group, a superannuation gap of 46.9%[1]. Further data based on the HILDA survey shows that among individuals aged 60 to 64, women hold 32.3% of superannuation accounts with balances in the top 10%, compared to 59.6% of balances in the lowest 50%. [2] ASFA analysis shows that although the superannuation gap has narrowed since the introduction of the superannuation guarantee, since 2009 the gap has not narrowed further.[3]

As discussed in the NFAW submission to the Senate Committee Inquiry into Women's Economic Security in Retirement last year, women are disadvantaged by the design of the superannuation system. Specifically, lower workforce participation rates mean that women do not earn as much over their working life and this is reflected in their lower superannuation balances at retirement.

High superannuation balances are also skewed to wealthy individuals, with 62.7% of the highest 10% of accounts by balance held by people in the top income quintile and 64.7% held by people in the

[1] Senate Economics References Committee 'A Man is Not A Retirement Plan: Achieving Economic Security For Women In Retirement ' (29 April 2016) p 9
[2] Roger Wilkins, 'The Household, Income and Labour Dynamics in Australia Survey: Selected Findings from Waves 1 to 14' (Melbourne Institute of Appled Economic and Social Research 2016) p 81.
[3] R. Clare, 'Superannuation Account Balances by Age and Gender' (ASFA, December 2015) <http://www.superannuation.asn.au/policy/reports> p 4

top wealth quintile.[4] Accordingly measures that limit excessive balances in superannuation accounts and tax exemptions for accounts with high balances must be supported.

To the extent that these bills improve the distributional equity of the superannuation system, the gender superannuation gap will also be reduced.

Transfer Balance Cap

The proposal to limit the amount that can be invested in a tax exempt environment during retirement phase should be supported. This is consistent with the proposed primary objective of superannuation as being to provide income in retirement to substitute or supplement the age pension. The value of the balance transfer cap at $1.6m for each person, whether single or partnered, would seem to be more than adequate to meet this objective.

The design of the transfer balance cap allows a person with more than $1.6m accumulated in superannuation prior to the retirement phase to retain the balance in superannuation, invested at the concessional tax rate applicable to the accumulation phase. This will continue to allow considerable tax concessions to retirees who would otherwise pay tax at normal marginal tax rates on investment income.

Alternatively the excess transfer balance can be withdrawn. The data show that investors at all income levels save for retirement outside of superannuation,[5] and income earned on those investments is taxed at personal marginal tax rates. The continued exemption of pension income when received by the retiree does, of itself, create a tax incentive in relation to income from other investments as the relevant marginal tax rates disregard the amount received from the pension, lowering the marginal tax rate applicable to other investment income.

Therefore although the application of the excess transfer balance cap is welcome, income earned on the transfer balance is still likely to be taxed at low or concessional tax rates.

Reduction in Concessional Contributions Cap

The reduction in the concessional contribution cap to $25,000 is consistent with the proposed primary objective of the superannuation system to ensure retirement income. The reduction in the cap will limit the capacity for over-contribution through voluntary concessional contributions.

In the 2016-17 year the maximum earnings base for payment of the superannuation guarantee is $51,620; accordingly a person who is only receiving superannuation guarantee support will not be affected by the reduction in the concessional cap.

There are certain groups of employees, including university academics, who are entitled to higher levels of superannuation support under employment agreements. The reduction in the cap will impact these employees to a greater extent than the general working population.

Workers over the age of 50 have been able to contribute more under the concessional caps than younger workers since the introduction of contribution caps in 2007. This was originally intended to allow members to catch up contributions at a time when other financial obligations have reduced.

Arguably, as the superannuation system matures there is less need to allow higher contribution caps for older workers as they will have been paying a higher rate of contributions for more of their working life: a person relying in the SG who was 50 in 2007 had only 5 years of contributions at the rate of 9% of ordinary income, compared to a person who is 50 in 2016 who will have had 14 years at 9% or higher. HILDA data show that the average balance of men aged 50 – 54 has increased by

[4] Above n 2
[5] John Daley, Brendan Coates and Hugh Parsonage, 'How Households Save for Retirement' (Grattan Institute, 2016)

$45,868 and for women by $30,845 between 2002 and 2012.[6] This represents an increase in balances of about 1/3.

In addition to the growth in superannuation balances as the system matures, older members are able to add to their balance through non-concessional contributions when other financial obligations have reduced.

The higher annual cap was poorly targeted, as high income earners were the most likely to be able to access additional concessional contributions. The current proposal to allow a person to carry forward unused non-concessional caps will be available to older workers who meet the requirements, which will to some extent address the original purpose of the increased caps for people over 50 years of age.

The decrease in the concessional contribution cap to $25,000 for all superannuation fund members should be supported.

Non Concessional Contributions

The most significant opportunities for tax planning arise through access to non-concessional contributions. Concessional contributions have always been more limited in scope, so it is the ability to inject additional funds into superannuation that has allowed some individuals to build very large superannuation account balances.[7]

Given that the tax payable on an investment influences investment strategy, the flat rate of 15% tax on investment earnings encourages the use of superannuation as an investment vehicle. For investors approaching retirement age, or with a long term investment focus, the limitations on withdrawal are not a significant barrier to using superannuation as an investment vehicle, particularly if they also have other forms of savings.[8]

Accordingly lower non-concessional caps, whether annual or lifetime caps, will improve the distributional equity of the retirement system. Although the lifetime cap is not included in this Bill, in my opinion it was a more equitable approach than allowing the existing annual caps to continue.

There is still the potential for people to use the transition from the current cap of $180,000 pa to the proposed $100,000 to inject substantial sums into superannuation. The retention of the three year bring forward rule with the deferred start date of 1 July 2017 has opened a window for large contributions to be made where the member has an account balance of less than $1.4m.

Low Income Superannuation Tax Offset (LISTO)

NFAW and other organisations representing lower income workers have argued strongly for the retention of the Low Income Superannuation Contribution since the repeal was first proposed. It is inequitable for low income earners to pay a higher average rate of tax on superannuation savings than on other earnings, particularly considering the compulsion attached to superannuation guarantee contributions.

As women are overrepresented among low income and casual workers who are expected to benefit from this offset, the reintroduction of tax concessions will be both redistributive and improve gender outcomes.

The current LISTO proposal is, on the face of it, very similar to the LISC. However structuring the credit as a tax offset rather than as a direct contribution will require the superannuation fund

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[6] Above n 2 at p 76
[7] John Daley et al, 'A better super system: assessing the 2016 tax reforms' (Grattan Institute, 2016) p 21
[8] Above n 5

trustees to process the relevant tax offset. It is important that the transaction does not incur fees that are charged to the member's account, eroding the value of the tax offset.

Deducting Personal Contributions

Removing the effect of the 10% rule would address a number of anomalies in the current contribution rules.

Firstly, the 10% rule applies to deny a person who is entitled to SG on 10% of their assessable income from claiming any further deductions for superannuation, regardless of whether they have contributed up to the concessional cap. In the current labour market it is frequently difficult to distinguish between a casual employee, a contractor who is covered by the superannuation guarantee as the contract is wholly or principally for their labour, and a contractor who is not covered by the SG. Frequently a person will move between positions and be treated differently by the person that has engaged their services. The dynamics of the current labour market make it difficult to justify the retention of this distinction.

Secondly, the current system gives an advantage to employees able to access salary sacrificing arrangements over employees that are not able to access such arrangements. Salary sacrificing arrangements must be prospective, not retrospective, which can make it difficult to implement in advance: for example employee bonuses may not be able to be determined accurately until performance criteria are assessed. It is anomalous to deny a tax deduction to employees who have not accessed salary sacrificing while another employee who has implemented a salary sacrifice agreement can exclude the same amounts from their assessable income.

The 10% rule predates the 2007 introduction of concessional caps which standardised the amount that could be contributed between employees and self-employed persons. Changes in the labour market since the rule was introduced have introduced anomalies that must be addressed.

Alternative methods to address the anomalies would include more rigorous scrutiny of contracting arrangements to ensure the correct classification of workers, and legislating to remove access to salary sacrificing arrangements.

Unused Concessional Cap Carry Forward

This proposal has been endorsed by a range of industry bodies on the basis that it will allow workers with an interrupted career path, who are predominantly women, to catch up on superannuation that was not contributed during the interruptions.

In 2015 I gave qualified support for the proposal to allow caps to be brought forward for a limited period of time. Although the proposal allows women who are earning a high wage the opportunity to catch up superannuation contributions, there are relatively few women who will be able to take advantage of the increased cap on returning to the workforce after a career interruption. In evidence before the Senate Committee I stated: "Most women who are earning the average wage would not be putting anywhere near $35,000 into superannuation through salary sacrifice—let us be realistic about this…. Annual caps are of use only if you have the money to actually put aside, and most low-income earners do not have the capacity to save that sort of money."[9]

Since the announcement of the proposal in the 2016-17 Budget, modelling has shown that catch up contributions are most likely to be accessed by younger high income men who are reaching their peak earning years[10]. The proposed measure is restricted to members with account balances under $500,000, however if the intention is to assist people returning to the workforce following career interruptions, it is poorly targeted.

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[9] Hodgson H; Evidence to Senate Economics References Committee Thursday, 19 November 2015 at p 37

[10] Above n 7 at p 14

Alternative targeting mechanisms that would better target access to the carry forward include testing eligibility against the work history of the member seeking to make the catch-up contributions; or allowing members over the age of 50 with low balances to access catch up contributions to replace the current higher concessional caps.

Tax Offsets for Spouse Contributions

As a matter of principle, schemes that promote income splitting between spouses should be opposed. The evidence shows that this is inefficient and inequitable, discourages women's workforce participation and usually does not result in a reallocation of economic assets between spouses.[11] The proposal to extend the existing low income spouse offset is a form of income splitting: it provides a benefit to the spouse making the contribution, and would be better as an additional contribution to the account of the recipient spouse.[12]

The Tax Offset for Spouse Contributions[13] has been in place since before the 2007 superannuation changes[14], but has been underutilised, in part because of the low income levels to qualify for the offset. The proposal to increase the income thresholds aligns the income levels with the Low Income Superannuation Tax Offset, addressing this concern.

To access the tax offset a contribution must be made to the recipient spouse account, which then can only be accessed by the recipient spouse when they meet a condition of release. The amount of a spouse contribution is not limited, but the tax offset is capped at $540, based on contributions of $3,000.

On balance, the current proposal is an improvement on the current scheme. Although the principle of income splitting should not be supported, in this case the contribution must be an actual contribution to the spouse account, which results in a lasting economic benefit to the spouse, and the tax benefit of $540 is unlikely to be significant in decisions regarding workforce participation levels.

Innovative Income Streams and Transition to Retirement Income Streams

Removal of the tax differences between pension streams and long term insurance products will facilitate long term retirement income planning by removing a barrier to the development of comprehensive income products for retirement. This measure, which is consistent with the recommendations of the Murray Report,[15] should be supported as it will improve flexibility and strengthen the long term sustainability of the retirement income system.

Transition to retirement income schemes (TRIS) predate the exemption for pension income received by a person over the age of 60 and were intended to assist in the transition from retirement by providing income support when a superannuation fund member reduces workforce participation without fully retiring. However the Productivity Commission has concluded that they are most commonly accessed by higher income earners who maintain their levels of workforce participation.[16] The consequence of entering into a TRIS is that the that the superannuation fund pays no tax on the income applied to support that income stream but also that the income stream is taxed as a

[11] Helen Hodgson, 'Taxing the Family - The Tax Unit: Should NZ Adopt a Family Based Income Tax?' (2008) 14(3) *New Zealand Journal of Tax Law and Policy* 398
[12] Helen Hodgson and Lisa Marriott, 'Retirement Savings and Gender: An Australasian Comparison' (2013) 28(4) *Australian Tax Forum* 725 at p 746
[13] *Income Tax Assessment Act* 1997 s. 290-230 inserted by No 9 of 2007
[14] Former s.159T *Income Tax Assessment Act* 1936 inserted by No 147 of 1997;
[15] David Murray et al, 'Financial System Inquiry Final Report' (Nov 2014) <fsi.gov.au/publications/final-report/>
[16] Productivity Commission, 'Superannuation Policy for Post Retirement' (Productivity Commission, July 2015 2015) <http://www.pc.gov.au/research/completed/superannuation-post-retirement> Vol 2, p 144

pension, either exempt or at a concessional tax rate in the hands of the recipient, providing a double benefit.

This could be addressed by reducing the tax benefit available to either the superannuation fund or the pension recipient. The technical solution proposed to address these changes is based on the superannuation fund being required to pay tax on as it will be excluded from the tax exemption available when a fund is in the retirement phase. There is no change to the treatment of the income stream in the hands of the recipient.

There are still tax advantages available to people entering into a TRIS, particularly if they are over the age of 60. An alternative approach in relation to the TRIS would have been to limit the tax concession on the basis of workforce participation, which would have met the policy intent more clearly. This could be measured by reference to the adjusted taxable income of the pension recipient, with the rebate or exemption tapered according to income levels.

However, taking account of the administrative complexities that this would introduce, the proposal in the bill does reduce the effectiveness of the TRIS as a tax minimisation strategy.

Concluding Comments

On balance the proposed measures will improve the targeting of superannuation tax concessions.

There are alternative measures that could be adopted to better target superannuation incentives and ensure that the policy is more cohesive. In particular the blanket exemption of income streams paid from a superannuation fund to a person over 60 allows arbitrage and manipulation of investment portfolios, including superannuation contributions. Consideration of scaling back this exemption has not been included as a part of the rebalancing of the system.

The reduction in superannuation contribution caps for both concessional and non-concessional contributions and the restoration of tax concessions for low income earners will improve the targeting of concessions but there is still a strong bias to the wealthy (high income and or assets) who will be able to access higher tax concessions by virtue of being able to contribute more to a tax sheltered environment.

The proposal for bring forward caps for concessional contributions is flawed as it is poorly targeted and is unlikely to be utilised by the group that it was intended to benefit.

The debate over retrospectivity has resulted in a delay in implementation of the changes, which has provided a window for people to restructure their retirement savings to take advantage of the current rules, and the transitional arrangements.