SUBMISSION 18

House of representatives Standing Committee on Economics, Finance and Public Administration

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The Secretary
Standing Committee on Economics, Finance and Public Administration
Parliament House
CANBERRA ACT 2600

Email: efpa.reps@aph.gov.au

Dear Sir/Madam

Inquiry into improving the superannuation savings of people under 40

CPA Australia welcomes the opportunity to provide a submission to the Committee's inquiry into improving the superannuation savings of people under 40.

Please find attached our submission for the Committee's consideration. Should you have any queries or require further information please contact the undersigned on 02 6267 8585 or by email: michael.davison@cpaaustralia.com.au.

Yours sincerely

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Superannuation Policy Adviser

CPA Australia

Submission to the Standing Committee on Economics, Finance and Public Administration Inquiry into improving the superannuation savings of people under 40

Executive summary

CPA Australia is the pre-eminent body representing the diverse interests of more than 105,000 finance, accounting and business advisory professionals working in the public sector, public practice, industry and commerce, academe and the not-for-profit sector.

CPA Australia is a long time advocate of superannuation as a retirement savings vehicle. We have worked closely with the Government and its departments, through consultation, providing comment on policy and legislative change, sitting on industry committees and appearing before various parliamentary inquires.

We are supportive of the current superannuation system and welcome recent positive initiatives such as the government co-contribution, the removal of the superannuation surcharge and improved flexibility and accessibility. However, we believe there are still a number of issues that discourage the use of superannuation as a long term savings vehicle.

We also welcome this inquiry into improving the superannuation savings of people under 40. However, we would like to note that the superannuation savings for the over 40s, and over 50s, is in a worse position, as they haven't enjoyed the compulsory superannuation guarantee or Government co-contribution for all their working lives, and have been subject to the superannuation surcharge for almost the last 10 years. As such, we request the committee consider these issues as well.

When considering barriers and disincentives to contributing to superannuation, particularly for younger Australians, CPA Australia has identified the following main issues:

- the taxation of superannuation is complex with taxes on contributions, investment income and final benefits.
- the 15% contributions tax acts as a disincentive and reduces the effectiveness of superannuation contributions considerably.
- superannuation is viewed as complex and constantly changing and there is genuine concern that the rules will change in the future adversely affecting retirement savings.
- younger Australians have competing demands for their income, such as housing, family and education, and when they do save it is generally through more accessible investment vehicles than superannuation.
- the annual age based contribution limits do not allow younger Australians to contribute extra to superannuation when they are most able.

- the self-employed are not entitled to the same superannuation incentives as the employed. In particular, they are unable to access a full tax deduction for their contributions and are ineligible for the Government co-contribution.
- since the introduction of the Financial Services Reform Act, it has become difficult to obtain financial advice where small superannuation amounts are involved.

These issues are discussed in more detail below, in our responses to the specific terms of reference of the inquiry.

CPA Australia believes that addressing the above issues will help simplify the superannuation system making it a more efficient vehicle for long term savings as well as providing greater incentive for voluntary contributions to superannuation.

Further to addressing these issues, a very positive incentive that could be put in place would be to establish an "adequacy", or income replacement target. Such a target would then give Australians a much clearer picture of what is needed in retirement and be used as a starting point when establishing their retirement savings plans.

CPA Australia's response to specific terms of reference

1. Barriers and/or disincentives to contribute to superannuation

Superannuation taxation

The taxation of superannuation is complex and multifaceted with taxes on contributions, investment income, and final benefits and also limitations on allowable deductions for superannuation contributions. Such complexity reduces the attractiveness of superannuation as a long-term savings vehicle.

Further, recent income tax cuts for individuals and companies, as well as the introduction of the GST have significantly undermined the relative tax effectiveness of superannuation as a retirement savings strategy. There is virtually no financial incentive in superannuation for income earners on the 15% marginal tax rate and only marginal advantage for those on average earnings (30% marginal tax rate), once the lack of access, due to the preservation rules, and cumulative impact of taxes are taken into account.

The 15% upfront tax on contributions reduces the 9% compulsory employer contribution to a net effective contribution of only 7.65%. Recent modelling conducted by the National Centre for Social and Economic Modelling (NATSEM) for CPA Australia, and contained in the report *Superannuation: The right balance?*[1] shows compulsory superannuation alone will not be enough for many Australians to maintain a reasonable standard of living in retirement, with couples and families being particularly hard hit. The modelling also demonstrates that the removal of the upfront contributions tax increases the standard of living in retirement by an average of 15% across all income groups. The removal of the upfront contributions tax would go a long way to ensuring more Australians have adequate retirement savings to maintain their standard of living in retirement.

[1] Superannuation: the right balance? NATSEM, CPA Australia, 2004

Complexity, constant changes and legislative risk

Feedback from CPA members suggest that many individuals are wary of superannuation because of its complexity and the real difficulty in understanding the benefits of superannuation.

The last few years, have seen numerous changes. Even where change has simplified the system or improved incentives, such as the removal of the employment test, the perception is that of yet another change adding even more complexity to the super system. This perception of complexity is a real disincentive for people to contribute to superannuation and has created a high level of mistrust of superannuation within the community.

Change has also led to superseded rules and conditions being grandfathered to ensure individuals are not disadvantaged by the change. This grandfathering adds to the complexity with multiple rules applying for things such as benefits tax, preservation and reasonable benefit limits.

There is also a genuine concern amongst younger Australians that, with their money locked away in superannuation for so long, under the preservation rules, the rules will change and their benefits may be adversely impacted, they may no longer be able to access lump sums, or their superannuation will be used to fund retirement benefits for older generations. One example that demonstrates this legislative risk (even though it didn't impact directly on younger Australians) was the immediate prohibition on self managed superannuation funds commencing defined benefit pensions announced on budget night 2004. This change had an immediate adverse impact on the retirement plans of many Australians, plans that had often been in place for many years.

Competing financial demands and other investment vehicles

Feedback from our members also indicates that younger people often face higher demands on their available income in the form of housing costs, particularly with large mortgages, raising a family and education, and often find it difficult to find the extra money to contribute to superannuation.

Research conducted for CPA Australia last year[2] for younger Australians are more comfortable carrying debt and are often using available income to service the debt instead of saving or investing it.

Where they do have income to save or invest, they are shying away from superannuation because it is viewed as inaccessible, with the long timeframes involved, and confusing and are instead turning to popular investments such as residential property and geared investments.

Another view that has been mentioned is that as the compulsory contribution level has been set by the Government at 9% of salary, that must be sufficient to provide an adequate level of income in retirement and so there is no need to contribute above this level. Following on from this, is a similar view that as the reasonable benefit limits are set at a particular level by the Government that must be what is needed in retirement, even though they do not take into account an individual's needs, expenses, desired retirement life stye, or longevity.

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[2] Debt and the "X" and "Y" Generation, Newton Wayman Chong, CPA Australia 2004

Contribution limits

The annual age based contribution limits prevent individuals making larger contributions to grow their superannuation savings when they are most able to. The current 2005/06 annual limits of:

Under age 35	$14,603
Age 35 to 49	$40,560
Age 50 & over	$100,587

are skewed towards individuals approaching retirement, allowing them to contribute larger amounts to top up their superannuation. However, there is no provision for younger people with possibly less financial commitments, such as a mortgage or family, and hence higher disposable income, to contribute extra to superannuation when they are best able to do so. The same applies for individuals who may be returning to the workforce, eg parents or students, who may wish to make up lost contributions.

One solution would be to remove the age based limits and introduce a lifetime contribution limit. Alternatively, the limits could be abolished altogether and reasonable benefit limits used to control available concessions. However, the level and indexation of the RBLs would first need to be reviewed. RBLs are currently indexed each year to increases in AWOTE while superannuation earnings are often greater than this. Over time, this will result in more superannuation benefits prematurely exceeding RBLs.

Inequitable treatment of the self-employed

Self-employed individuals do not have the compulsory 9% superannuation guarantee paid on their behalf and generally are not entitled to the same superannuation incentives that are available to employees.

A substantially self-employed person can claim a tax deduction for superannuation contributions up to $5000 plus 75% of the amount over $5000, subject to the age-based limits. In comparison, contributions made by employers for employed individuals, including salary sacrificed amounts, receive a full tax deduction, up to the age based limits. Essentially, a self-employed individual must contribute more to have the same amount go into their superannuation fund. This represents an unfair difference and discourages self-employed people from contributing more than $5,000 pa. In some circumstances the employer is entitled to a lesser deduction for their own contributions than those for their employees.

Many self-employed people save for their retirement through their business. This can generate a valuable retirement benefit. However, business failure statistics indicate that this is a high risk strategy as the individual's retirement income is linked to the operation and success of their business. The Productivity Commission in its report *Business Failure and Change in Australia* found that only 50 percent of small businesses continue to exist after 10 years. This implies there is a significant risk of the self-employed having all their savings in the one basket. Therefore, it is imperative that independent superannuation savings are also encouraged.

Changes to the eligibility requirements for the Government co-contribution for low and middle income earners, where you must now earn at least 10% of your income from employment to be eligible, disadvantage low income earning self-employed individuals. As an example, an employee earning $25,000 is able to personally contribute $1,000 after tax to superannuation (at a total pre-tax cost of $1,460) and receive the maximum co-contribution of $1,500, effectively a total contribution of $2,500 to their superannuation. On the other hand, for a substantially self-employed individual earning $25,000 to have a net contribution of $2,500 to their superannuation, they must make a pre-tax contribution of $2,941 (allowing for the 15% contributions tax), which equates to an after tax amount of $2,015 after the allowable deduction for the contribution. That is, the self-employed individual must contribute the equivalent of an extra $1,000 of after tax income to achieve the same outcome. This inequity could be removed if the co-contribution scheme was amended to allow low-income self-employed persons the option of claiming the co-contribution or a tax deduction on their superannuation contributions.

Access to financial advice

With the introduction of the Financial Services Reform Act, the complexity and cost of providing financial advice has increased considerably. Feedback from licensed financial planners indicates that is very difficult to provide cost effective advice where smaller superannuation balances or contributions are involved.

Conversely, where financial advice is available, it is the younger people with the smaller balances and contributions who find advice too expensive and often go without, increasing the risk that poor superannuation or investment decisions may be made.

2. Current incentives to encourage voluntary superannuation contributions

The primary incentive to contribute to superannuation continues to be the concessional tax treatment it receives. However, these incentives are not uniform across all income groups, have been diminished by recent cuts to personal and company income tax rates and the introduction of the GST, and do not fully compensate for the lack of accessibility.

After tax, or undeductible, contributions can be attractive compared to other investments (except for individuals subject to the 15% marginal tax rate) as they are not subject to contributions or benefits tax, and any earnings are only taxed at up to a maximum rate of 15%. However, this attractiveness diminishes when compensation for the lack of accessibility is considered or when compared to, increasingly popular, geared investments.

Taxable contributions, such as voluntary employer, salary sacrifice and self employed contributions, are only attractive to individuals on the higher marginal tax rates where the higher deduction compensates for the cumulative effect of the contributions tax, earnings tax and possible benefit tax. For the majority of Australians on the 30% marginal tax rate or below, these contributions are not attractive, especially when the lack of accessibility is taken into account.

The Government has also recently introduced, or is about to introduce, a number of other measures, such as the co-contribution, removing the superannuation surcharge, improving the accessibility of superannuation and contribution splitting, that will provide greater incentive to make voluntary contributions to superannuation. These measures are discussed in more detail below.

Abolition of the superannuation surcharge

The abolition of the superannuation surcharge was an important step in simplifying our superannuation tax laws. The surcharge imposed very significant compliance costs on funds and their advisers and was a highly inefficient and regressive tax. Not only did it impact on higher income earners, it particularly impacted on women returning to the workforce and low income workers receiving large one-off redundancy payments. Its removal will provide considerable incentive for higher income earners to make voluntary contributions to superannuation and will also ensure contributions are given a greater opportunity to grow.

Government co-contribution

The Government co-contribution has so far been a great success according to Government reports and anecdotal evidence from superannuation funds. With the increased coverage and more generous benefit, the co-contribution is a very positive incentive.

However, as discussed previously, it does not provide universal coverage with self employed individuals on low incomes being unable to access it. Further, the increases to the marginal tax rates announced in the 2005/06 Federal Budget highlight the gap in incentives for many 'average' income earners subject to the 30% marginal tax rate. While individuals earning less than $58,000 can access the co-contribution and for those earning greater than $70,000, salary sacrifice is tax effective, there are no incentives for those in between to make voluntary contributions. This could be addressed by lifting the co-contribution thresholds to be more aligned with the new marginal tax rates.

Access to superannuation

The introduction last year of the measures contained in the Treasurer's *A more flexible retirement system* announcement of February 2004, particularly the removal of the link to employment for under 65s, has meant that superannuation is now much more accessible for the majority of Australians and has made contributing to superannuation much easier for individuals out of the workforce.

Contribution splitting

The proposed introduction of contribution splitting from 1 July 2006 is another welcome measure and CPA is fully supportive of it. We believe the ability to split superannuation contributions with your partner thus maximising your superannuation by taking advantage of two RBLs and two tax free thresholds will provide considerable incentive to make additional voluntary contributions.

However, we continue to be opposed to the Government's proposed method of annual contribution splitting. Splitting contributions at the end of each year and transferring them to your partner will be unnecessarily complex and costly. Firstly, couples will need to determine each year if they need to split contributions and the amount to split to ensure they are able to maximise their combined superannuation at retirement, which may be a considerable period away, and will most likely need to seek financial advice to do so. Secondly, a couple will need to maintain two superannuation accounts, not only incurring multiple fees and paperwork, but also increasing administration costs for all superannuation fund members.

For these reasons, we believe this measure will not be utilised to its full potential and an opportunity to improve superannuation savings may be missed. As an alternative, we believe splitting the end benefit at the time of retirement would be much more effective. Couples would only have to make the decision once, at the time they are best able to assess their needs in retirement, and they would be able to avoid the cost of annual financial advice and multiple superannuation accounts.

3. Improving awareness of the importance of saving early for retirement

While we do not have any specific points to raise about improving awareness, we do believe the establishment of the Financial Literacy Foundation and the education campaign supporting the introduction of choice of fund are good first steps in improving the awareness of superannuation.

When considering ways to improve awareness, it is worth noting some of the findings out of CPA Australia's research into generation X and Y's attitudes to debt[3]. It was found that many young Australians consider debt to be an acceptable method to get what they want now and see saving as something to be done in the future. However, they do see saving as their responsibility and not that of the Governments.

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[3] ibid.