

14 February 2006



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

House of representatives Standing Committee on Economics, Finance and Public Administration	
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Secretary:.....	<i>HS</i>

INQUIRY INTO IMPROVING SUPERANNUATION SAVINGS OF PEOPLE UNDER AGE 40

Dear Committee Secretary

Please find attached my third submission to this inquiry.

This submission details three ideas that would provide an incentive to get young people to place more funds into superannuation.

My Suggestions in summary are as follows

- **0% Tax on salary sacrifice up to ABIRT Curve –**
(Age Based Income Replacement Target)
- **Use unlimited co-contribution to pay HECS Debt.**
- **Access to Salary Sacrificed Contributions-**
(Salary Sacrifice Reversed)

All three combined provide the ability to use 100% of your gross salary into a tax friendly environment if you have a low balance, reduce HECS debt as quickly as possible, and provide flexibility to park and access the bulk of your savings by reversing salary sacrificing contributions back onto your taxable income.

Your Sincerely

Christopher Moore

0% Contribution Tax on Salary Sacrifice

- Retain 15% entry tax on super guarantee; this is not a disincentive to contribute more. Though reducing it would help increase my final balance.
- Reduce entry tax to 0% on salary-sacrificed contributions.
- If I'm on 30 cents in the dollar tax bracket, why pay off the mortgage with \$70 dollars on a mortgage rate of 6.75%, whereas I can use \$100 to earn 10% to 14% in a Geared Share Fund within a super fund.
- Hence super is more competitive against negative gearing and paying of your mortgage sooner.
- The reduced contribution tax on salary sacrifice would be limited by the ABIRT Curve (Age Based Income Replacement Target). It is used as a method of means testing how much tax concession you receive on salary sacrificed amounts.
- By stealth ABIRT acts as a guide of your future super balance in today's dollars if you can keep up with the curve.
- It helps those with smaller balances and incomes. Casual, part time, and women taking leave for children and then returning to the workforce would benefit the most.

How it would work

If your super balance is below the ABIRT (Aged Based Income Replacement Target) curve, you pay 0% tax on your salary sacrifice amounts. Once your balance reaches the curve, salary sacrifice contributions are taxed at 15%.

The ABIRT curve is adjusted up each year in line with the Reasonable Benefit Limits.

The ABIRT target at age 65 = **\$370,000**. Using current means testing arrangements, assuming a male aged 65, with a life expectancy of 18years using a market linked annuity, and the first year income = 7.58% of the balance, he would receive **\$30,967**. If this amount were re-contributed his income would be **\$36,794**.

By re-contributing, his age pension entitlement jumps from \$112 per fortnight to \$439 per fortnight.

Scenario Modelling for Salary = **\$35,000**

Earnings Rate = 7%

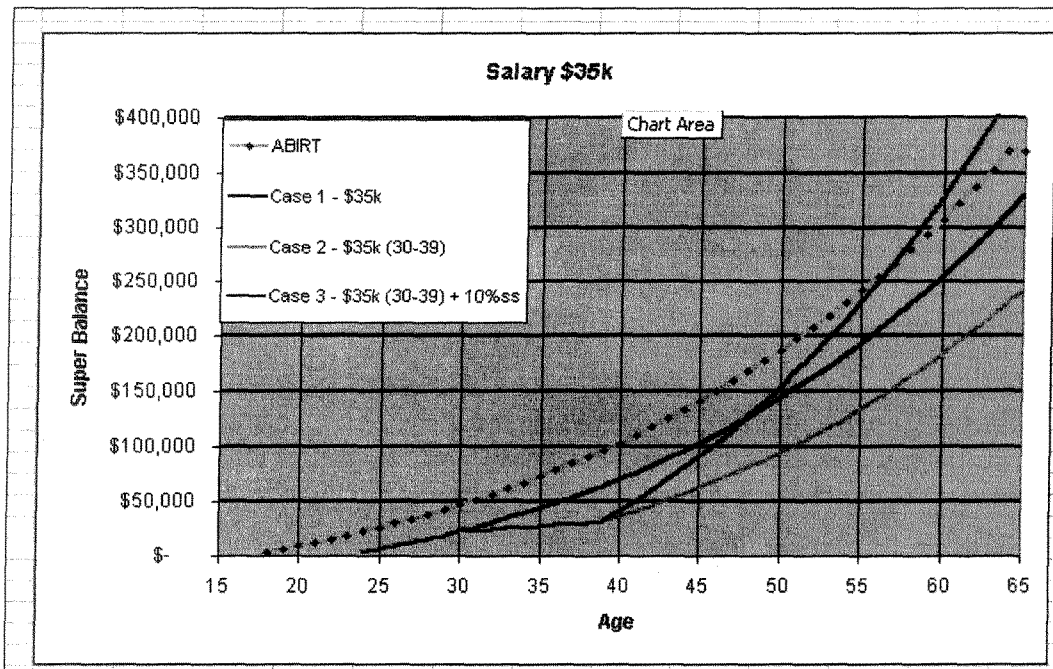
Balance of each year deflated by 3%

All numbers in today's dollars

Case 1 - Base case of an employee contributing 9% SG from age 23 to 65.

Case 2 - Base Case, + no employment from age 30 to 39

Case 3 - Base Case, + no employment from age 30 to 39, + Salary Sacrifice 10% at age 40 onwards



Results

Case 3 (Blue Line) would be a typical curve for a women on a lower than average income, then having children from age 30 to 39, then re-entering the workforce and contributing 10% salary sacrifice. She has the incentive to pay no tax on her salary-sacrificed contributions into super up until age 57. (Blue line crosses the yellow dotted line)

At age 30, the ABIRT is at \$46,825, yet a typical balance would be \$22,506, so to fill up the account, effectively \$24,319 of salary spread over a number of years would be tax free.

But from then on it is likely their super balance will keep pace with the ABIRT curve so no further tax concessions are allowed.

Using the above example, Governments revenue loss would be as follows

$$\$24,319 \times 0.30 \text{ tax} = \$7,295$$

Scenario Modelling for Salary = **\$53,000** *Average Weekly Earnings*

Earnings Rate = 7%

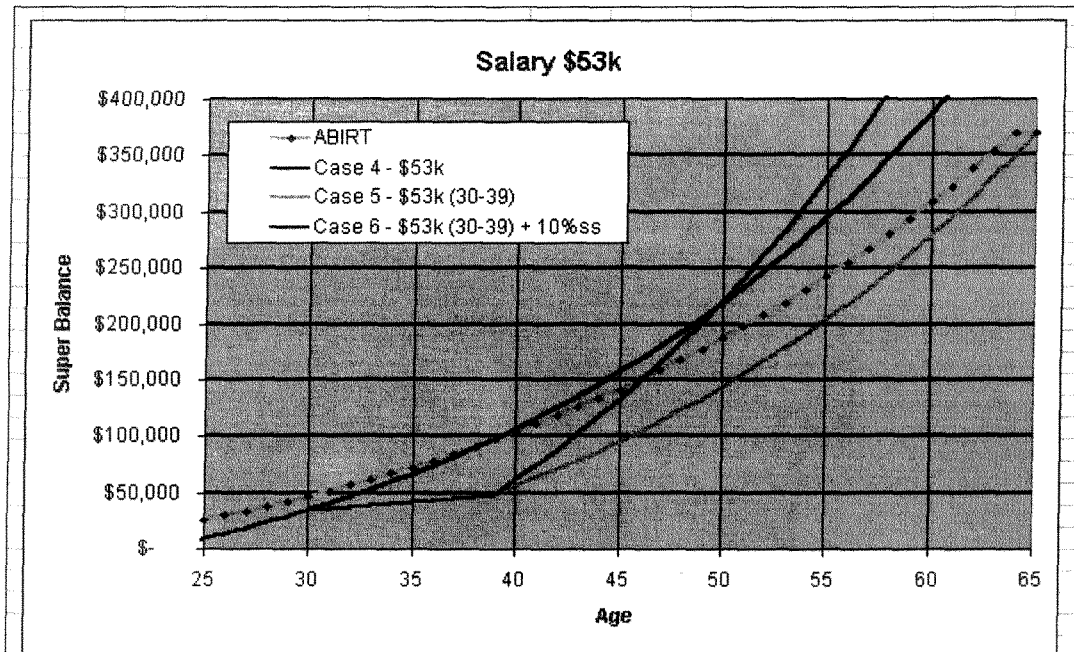
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Case 1 - Base case of an employee contributing 9% SG from age 23 to 65.

Case 2 - Base Case, + no employment from age 30 to 39

Case 3 - Base Case, + no employment from age 30 to 39, + Salary Sacrifice 10% at age 40 onwards



Results

Case 3 (Blue Line) would be a typical curve for a woman on average weekly earnings, then having children from age 30 to 39, then re-entering the workforce and contributing 10% salary sacrifice. She has the incentive to pay no tax on her salary-sacrificed contributions into super up until age 46. (*Blue line crosses the yellow dotted line*)

At age 30, the ABIRT curve is at \$46,825, yet a typical balance would be \$34,345, so to fill up the account, effectively \$12,480 salary sacrificed would be tax free. But from then on it is likely their super balance will increase faster than the ABIRT curve so no further tax concessions are allowed.

Using the above example, Governments revenue loss would be as follows
 $\$12,480 \times 0.30 \text{ tax} = \$3,744$

At age 40, case 4 (red line) shows that super guaranteed contributions alone will surpass the ABIRT curve. Meaning that after age 40 they are not entitled to a tax concession on their salary sacrificed contributions.

Advantages

- 0% Tax on salary sacrifice is a big incentive
- The example above of someone on a lower income shows the benefit would be an incentive until almost preservation age.
- Lower income earners and those with broken work patterns i.e. women having family are significantly advantaged
- High income earners would receive no tax concession in the later years, but maybe some in the initial few years.

Disadvantages

- May only be feasible under a mature super system
- Many older people have low balances, so government will be providing a lot of tax concessions now.
- May not work well with the new transitions to retirement

Comments

The idea of providing a tax concession to salary sacrificed amounts below ABIRT would apply to almost every person under age 40, on average and low incomes.

Depending on government finances, contributions tax on both salary sacrifice and super guarantee could be removed if your balance is below the ABIRT curve, meaning those anticipating a lower retirement income are provided a tax concession.

Essentially the ABIRT curve provides the government with a mechanism to limit the amount of 0% contribution tax. Once the account fills up to the curve no more tax concession is allowed if the account keeps pace with the curve. By applying this strategy, the tax saving may seem small using my ABIRT curve, but it would significantly reduce the benefit to high income earners that don't need it.

I am unsure how this would work after preservation age where people live on an annuity income stream, but still working and salary sacrificing at the same time. Having an extra 15% tax concession would seem unfair.

To make it really attractive for those under age 40, the curve could be designed as a flat line at \$100,000, from age 18 to 40, then follow the curve after age 40 through to age 55 or 65 depending on how it would work.

But the most important part is that salary sacrificed amounts are taxed at 0%.

Use Co-contribution to pay HECS Debt

- Anyone with HECS debt, allow an **unlimited co-contribution** to be directed towards reducing HECS debt. For every \$1000 invested in super as an undeducted contribution, the co-contribution will be directed towards HECS debt reduction.

Example

A young employee with a \$42,000 salary with a HECS debt could pay off their debt sooner by using unlimited co-contributions. For every \$1000 they are entitled to an \$800 co-contribution. So if an undeducted contribution were made to super of \$5,000 in a single year, they would receive \$4000 (5x\$800) that would be directed by the tax office and payed off their HECS debt.

Essentially they are receiving 5 years of co-contribution in 1 year. So they are accelerating their debt reduction, by investing in Super.

If the young employee were on a \$28,000 salary and made an undeducted contribution of \$5,000 they would receive \$7500 (5x\$1500) that would be directed by the ATO towards their HECS Debt.

Advantages

- This is extremely attractive for low-income earners to pay off their HECS debt.
- The more they invest in super, the more years of co-contributions they receive in a single year to accelerate debt reduction. They are also accelerating their savings.

Disadvantages

- May not be popular for middle income earners
- Abuse by high income earners who take a year off with no salary and wipe out their debt in a single hit using the full \$1500 to \$1000 ratio. So maybe place a limit on the amount, or just use the current limits.

Comments

My first thoughts on the use of co-contribution for HECS reduction were to use the maximum co-contribution of \$1500 for every \$1000 placed into super, and make it unlimited for all income levels.

Example

Assuming you have a \$15,000 HECS Debt, you could make a \$10,000 undeducted contribution into super, and \$15,000 of co-contribution would pay off your HECS Debt in a single year. I asked two fellow employees aged in their mid 20's with HECS debt if they would use this. Their response was "hell yeah".

Essentially this is 10 years worth of co-contributions for someone with a salary of under \$28,000. But many uni students end up on average weekly earnings after a few years, so this may be unfair.

And secondly it would be so popular that government would have no funding for universities because they are not receiving the \$10,000. The \$10,000 ends up in the super fund.

But at least everyone with a HECS Debt would be throwing every penny plus the kitchen sink into super.

The following table shows some simple calculations on how the numbers can be justified. I have used a super balance of \$370,000 and added on the extra \$33,609 to work out the difference for age pension calculations over a life expectancy.

	J	K
Undeducted Contribution invested in Super Fund at age 25	\$10,000	
Co-contribution paid to reduce HECS Debt	-\$15,000	
Earnings on Super before tax but after fees	8.0%	
Tax rate on earnings	10.0%	Capital Gains Tax
Deflator used to adjust to Average Weekly Earnings (AWE)	4.0%	
Balance at age 65	\$ 161,358	Actual Dollars
Balance at age 65 deflated against AWE	\$ 33,609	Today's Dollars
Total Age Pension paid over life expectancy with extra Undeducted Contribution	\$ 70,623	p.a.
Total Age Pension paid over life expectancy without Undeducted Contribution	\$ 83,199	p.a.
Life expectancy	18 years	
Total amount of age pension not paid over life expectancy	\$ 12,576	Today's Dollars
Total amount of tax on super earnings	\$ 5,902	Today's Dollars
Total amount government spent to pay HECS	-\$15,000	Today's Dollars
Net effect on Government Expenditure	\$3,478	saving

Unfortunately the government would have to pay the \$15,000 upfront and would only see the savings return over a 40 to 60 year period. Meaning this strategy would require borrowings by the government, at which interest would accrue, thus effectively making this strategy unworkable.

All I'm trying to show is that tax on earnings and reduced age pensions equals the co-contribution that the government forgoes upfront, if it did not borrow as such to fund this strategy.

Access to Salary Sacrificed Contributions (*Salary Sacrifice Reversed*)

Access to your own contributions is the biggest disincentive to using super.

Accessing salary-sacrificed amounts could simply carry a 15% tax credit, which the income from super and the tax credit would be added to your taxable income in the year the money is taken out. Just like the dividend imputation system.

Example

Assuming 15% entry tax and 15% earnings tax

If I were to take out \$850, this would also carry a \$150 tax credit. A total of \$1000 would be added to my taxable income. Just like a dividend payment from a share that carries imputation credits, because tax has already been paid.

The following shows how the income from super would be treated.

0% Tax Bracket	-	\$150 rebated
15% Tax Bracket	-	\$0 rebated
30% Tax bracket	-	\$150 tax payable
42% Tax bracket	-	\$270 tax payable
48% Tax bracket	-	\$330 tax payable

Advantages

- Same as receiving a dividend payment from shares.
- Allows anyone to push the bulk of their savings into super and have the ability to withdraw it and have it taxed the same as their normal income.
- Extremely attractive for women having a family.

Example

Say after finishing university a woman on average weekly earnings of \$53,000 salary sacrifices 10% of her income for 10 years into super. This extra amount would equate to roughly \$65,000. She then takes leave without pay for 3 years, and can simply draw down on the \$65,000.

For example, she takes \$10,000 per year.

Assuming no other income, Her taxable income in each year will be \$11,764.70 (\$10,000 income + \$1764.70 tax credit). Tax payable using 2005/06 tax tables = \$1041. So she would also be rebated \$723. (\$1764 already payed - \$1041 tax due).

Calculations

$$\$11764.7 \times 0.85 = \$10,000$$

$$\$11764.7 \times 0.15 = \$1764.70$$

Disadvantages

- Smoothing by negative gearers, i.e. in a low income year. By increasing your taxable income to a higher tax bracket, you increase your tax deduction.

Comments

By adding the gross amount (income + tax credit) to your taxable income, you are essentially reversing the salary sacrifice. Or adding the tax paid by the super fund back onto your gross income. So it's as if you never placed the money in super. And thus the money is taxed at your current rate of tax.

This would **not** be an effective savings vehicle for home purchase, because if for example you withdraw \$50,000, this amount has to be added to your taxable income. Meaning if you earned the money at a 30% tax rate, you would probably push your income into the 42% tax bracket when withdrawn. Thus paying more tax.

If a cap were placed on the amount withdrawn each year, e.g. \$5,000 to \$10,000, I don't think people would place the bulk of their savings in super. For that to occur a very large sum of say \$50,000 or \$100,000 would be more appropriate. This would provide flexibility if you changed your mind and needed a deposit for a house or updated your car later on in life. It means you can place the bulk of your savings in super and draw down what you need, leaving the rest in a tax friendly environment.

Simple Alternative –

Simply add the income drawn down to your taxable income without a tax credit. This would mean paying more tax on the income received, because you don't receive the tax credit. But it would be very simple. There would be a disincentive because you are over taxed but not by much

Example

15% contribution tax on \$1000 leaves \$850. Then if the \$850 is taken out of super and added to your tax bracket of a high income earner on 48% tax, then you are left with \$442. So you have paid 55.8% tax for someone on a 48% tax bracket.

Administration cost would be minimal but the extra tax could be seen as the disincentive to accessing.

Unpopular Alternative

Withdrawal of salary-sacrificed amounts could be assessed as excess benefits. i.e. taxed at 38.5% tax on withdrawal. This would not be rebated. This means to access super everyone would lose half of what they put in. I feel this would be very unpopular. You would only be doing this if you really needed the money. But I guess this is what the government want.