Investment & Financial Services Association Ltd

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9 June 2009

Committee Secretary
Senate Economics Committee
Parliament House
Canberra ACT 2600

By email: economics.sen@aph.gov.au

Dear Committee Secretary

Re: Inquiry into the Tax Laws Amendment (2009 Budget Measures No. 1) Bill 2009

IFSA welcomes the opportunity to participate in the Senate Economics Committee inquiry into the Tax Laws Amendment (2009 Budget Measures No. 1) Bill 2009.

Schedule 2—Government Co-contribution for Low Income Earners

It is regrettable that the matching rate for the Super Co-contribution has been temporarily reduced from $1.50 to $1, as this compelling incentive has made the scheme enormously successful.

IFSA welcomes the fact that the reduction in the matching rate is only temporary and is scheduled to be reinstated as economic conditions improve.

IFSA notes that the Super Co-contribution is one of the issues being considered by the Australia's Future Tax System (Henry) review.

Schedule 3—Excess contributions tax

<u>Background</u>

IFSA is disappointed that the 2009 Budget reduced the superannuation concessional contributions cap for Australian workers.

The concessional contributions caps limit the amount of pre-tax superannuation contributions that an individual can make, and include both compulsory Superannuation Guarantee (SG) and salary sacrifice contributions. The contributions are subject to tax at a rate of 15 per cent in the superannuation fund.

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The Budget announced that the concessional contributions cap would be reduced with effect 1 July 2009 to $25,000 for those under 50 and $50,000 for those 50 and over. The higher cap for the over 50s is due to expire on 30 June 2012.

This is a reduction of more than 50% given the concessional cap would otherwise have increased to $55,000 in 2009-10 due to indexation.

Low superannuation balance levels

Cutting the contribution caps so severely is a disappointing decision, primarily because a reduction in the contributions caps penalises older Australians who haven't had the chance to accrue large superannuation balances, either due to their age or due to time spent away from the workforce to raise a family.

Most of the people affected have not had the benefit of a savings system with compulsory SG contributions for their entire working life, and certainly not too many years at today's rate of 9%. This change will also disadvantage many self-employed individuals who lack a regular income.

Based on a sample survey of approximately 8000 affected contributors, IFSA found that of the over 50 year old age bracket who were contributing more than $50,000 to super, the average account balance was approximately $215,000. 26% of affected contributors were women. Balances of this level are unlikely to fund an adequate income in retirement.

Inconsistency with observed savings patterns

Consumer research prepared by TNS for IFSA indicates that superannuation does not register as a long term investment for those under the age of 39.

When asked the following question in June 2008 - "Of the following investment options, which do you believe is the best long-term (over five years) investment option at the moment?"

- Only 12 - 13% of individuals aged under 39 nominated superannuation. This compares to 42 - 50% who nominated property or the family home.
- More than a quarter of individuals over the age of 50 nominated superannuation.

Many Australians are unable to contribute additional amounts to superannuation in their 30s and 40s due to more pressing commitments such as raising children and repaying their mortgage. It is only when individuals enter their 50s that contributing extra to super becomes more feasible.

The AMP Superannuation Adequacy Report provides stark evidence of the importance of allowing older workers to make higher contributions to superannuation. The report is based on data from more than 322,000 AMP members. Table 3 of the report is reproduced below and identifies contribution rates by age.

As can be seen from the table, salary sacrifice contributions dramatically increase in popularity for workers above the age of 50. Given the estimates in the table are population wide averages; there would inevitably be individuals over the age of 50 salary sacrificing 20% of their salary to superannuation.

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TABLE 3: CONTRIBUTION RATES BY AGE, JUNE 2008

Age	Super Guarantee (SG)/Award	Salary sacrifice	After-tax	Total
20-24	9.5%	0.6%	0.3%	10.3%
25-29	9.5%	0.7%	0.2%	10.4%
30-34	9.5%	0.9%	0.3%	10.7%
35-39	9.5%	1.4%	0.4%	11.3%
40-44	9.5%	1.5%	0.4%	11.4%
45-49	9.5%	2.1%	0.6%	12.2%
50-54	9.5%	3.8%	1.0%	14.3%
55-59	9.5%	6.7%	2.0%	18.2%
60-64	9.5%	9.1%	3.7%	22.2%
65-69	9.5%	10.5%	5.7%	25.7%
All workers	**9.5%**	**2.4%**	**0.8%**	**12.6%**

Source: The AMP Superannuation Adequacy Report, January – June 2008

To put this into context, ABS statistics indicate that housing costs represented 20% of the gross income of the average household with a mortgage in 2005-06.[1] Contributing 20% of gross salary to superannuation can therefore easily result after the loan on a family home has been repaid.

A contribution cap of $25,000 would therefore affect individuals who are not generally considered to be high-income earners. For example:

<u>Example 1</u>

Tini is 60 and working full-time. Her annual salary is $100,000 per annum (plus superannuation). Tini is a member of her employer's default superannuation fund and currently receives $9,000 in SG contributions from her employer.

From 2012-13, Tini's concessional contribution cap will be $25,000 or $14,000 once her employers SG contributions are taken into account.

Tini has a low superannuation balance due to time out of the workforce and is seeking to make catch-up contributions. The maximum she can salary sacrifice is 14% of her income.

<u>Example 2</u>

The facts are as in Example 1 except Tini's employer also provides her with life insurance through a superannuation fund. The annual cost of the premium is $1,000 which is paid by her employer.

From 2012-13, Tini's concessional contribution cap will be $25,000 or $13,000 once her employers SG contributions and insurance premiums are taken into account.

The maximum Tini can salary sacrifice is 13% of her income.

[1] ABS Catalogue No. 4130.0.55.001, Housing Occupancy and Costs Australia 2005-06

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Behavioural response

In Example 1 above, if Tini had been salary sacrificing 20% of her income ($20,000 per annum) she will have to change her behaviour and look to other ways to invest the pre-tax income of $6,000 which remains after the maximum salary sacrifice of $14,000.

Tini is effectively forced to under utilise the only investment holding structure in Australia that is tailor made to build up capital that will eventually be used to fund her retirement.

Of course, she could pay income tax on the $6,000 and invest the after-tax amount in superannuation as a non-concessional contribution.

However, in an effort to replace the tax effectiveness of superannuation she may look to borrowing/gearing strategies often used in non-superannuation alternatives.

For example, she could consider borrowing to fund an investment which produces tax deductible interest of $6,000 pa.

This non-super alternative will have a greater up-front cost to the Government as no 15% contributions tax is payable, and Tini is exposed to all the risks associated with gearing. Furthermore, all the regulatory rules around super, such as preservation, do not apply to non-superannuation alternatives.

Recommendation

Historically, the superannuation system recognised that individuals have a greater capacity to save for their retirement as they age by imposing age-based limits on superannuation contributions.

The Better Super reforms sought to, over-time, introduce a single flat contribution limit. Critically, the single contribution limit was set at a generous level to provide for the wide-variety of circumstances that individuals face over their lifetime.

IFSA believes that the Parliament should revisit the appropriateness of a single flat contribution limit given the proposed move towards a stricter contribution cap.

IFSA suggests that a reasonable compromise would be retain the higher contribution limit for the over 50s of $50,000 per annum permanently. This compromise would not have a cost to revenue until the 2012-13 and subsequent financial years when the higher cap for the over 50s is due to expire.

Please do not hesitate to contact myself or Daniel Caruso on 02 9299 3022 if we can be of further assistance to the Committee in its inquiry.

Yours sincerely

John O'Shaughnessy
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