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31 July 2002

Chair
Senate Select Committee on Superannuation
Parliament House
Canberra ACT 2600

Dear Senator Watson,

The purpose of this letter is to respond to three questions on notice which were asked of us when we appeared before your Committee on 9 July.

1. Tax treatment of housing

You asked our views on the preferential tax treatment of owner occupied housing.

It is widely accepted that owner-occupied housing is very concessionally taxed, mainly due to the exemption of the principal residence from Capital Gains Tax. Although there is a case for public support for home ownership, this concession arguably benefits the well off much more than those on modest incomes. It also arguably distorts investment decisions and markets in undesirable ways, at least at the top end of the market. This leads to an excess of speculative investment at that end of the market, which fuels inflation in house prices during economic booms. In addition to the economic damage this can cause, sharp increases in luxury home prices spill over into other segments of the market, making a first home less affordable for many people.

Ideally, subsidies for home ownership would be based on a fixed flat amount, akin to the First Home Owners Scheme, and Capital Gains Tax would at least apply to luxury homes. One difficulty with this, apart from likely political resistance, is that wealthy home-owners would then be able to deduct their home loan interest costs. In some other countries where CGT applies to the sale of owner occupied housing, the cost of deductibility probably exceeds the additional CGT revenue obtained. The reason for this is that interest deductibility is relatively open-ended, while the tax base for CGT on owner occupied housing has been eroded over the years due to political lobbying.

Another way to address the tax bias in favour of speculative investment in luxury housing is to extend State Land Taxes to luxury owner occupied properties. The present incidence of residential Land Tax is probably regressive, to the extent that the tax is passed on to private tenants by their landlords. Extending Land Tax to luxury owner-occupied properties, as was recently done in New South Wales, makes this tax fairer. It also "compensates" to some extent for the under-taxation of investment in luxury owner occupied housing.

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2. NATSEM modelling

Senator Sherry asked about the assumptions made in the NATSEM study with regard to fees and charges.

We have not been able to directly clarify the assumptions made in this particular study. However, in other studies they have adopted the assumption of a 1% fee or \$50 per annum, whichever is greater.

We acknowledge the Senator's argument that fee levels can make a major difference to retirement incomes and that action to keep them within reasonable bounds is necessary.

We nevertheless consider that, overall, the NATSEM study is based on a reasonable set of assumptions. It provides the best available estimates of the relationship between future retirement income standards and those enjoyed during working life. No other Australian study has consistently taken variations in the cost of living before and after retirement into account.

3. Removal of indexation on the Lump Sum RBL

You asked us our views on your suggestion that indexation be removed from the RBL for lump sum payments.

While this would reduce incentives to take benefits in lump sum form over time, the current RBL is so high (in excess of \$500,000) that it exceeds average lump sum payments by a wide margin. This means that the measure would have no effect on the vast majority of superannuants for decades to come.

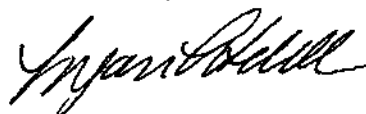
For this reason, we prefer a lump sum ceiling equivalent to the current tax free threshold for lump sums - around \$100,000. Above this level (which would be indexed) lump sum benefits would either be prescribed or taxed at a penal rate.

One advantage of this approach is that it would no longer be necessary to offer excessively generous tax subsidies to superannuants to convert to complying pensions.

We believe this measure would be more palatable to fund members if it were phased in, and they had greater access to part of their compulsory superannuation savings for other purposes. There would be a trade-off: more flexibility in the use of superannuation during working life in return for greater constraints on the use of retirement benefits.

I trust our responses are of assistance to the inquiry.

Yours sincerely



Megan Mitchell
Director