16 August 2002

Senator Watson
Chair
Select Committee on Superannuation
Parliament House
Canberra

Dear Senator

Re: Superannuation and retirement living standards

Attached is a supplementary submission from ACOSS to this inquiry. Its purpose is to clarify some of the detail of our proposals for a *long-term savings rebate* and *lifelong savings system* in response to comments on these proposals contained in a recent submission from the Association of Superannuation Funds of Australia.

Should you have any queries about this submission, please contact Peter Davidson, our Senior Policy Officer, at this office.

Yours sincerely

Megan Mitchell
Director

Supplementary submission to Senate Select Committee on Superannuation
Inquiry into superannuation and standards of living in retirement.

The purpose of this supplementary submission is to further clarify our proposed long-term savings rebate and lifelong savings system, and the arguments in favour of this approach, in view of a series of claims made by the Association of Superannuation Funds of Australia in its supplementary submission of August 2002.

1. Abolition of contributions taxes would render the system even more unfair than it is now

One of the arguments advanced by ASFA for the abolition of contributions taxes is that this would improve the equity of the superannuation system.

We argued in our original submission that the most serious inequity in the tax treatment of contributions is the flat 15% tax applying to employer contributions, whereby:

- a high income earner on $60,000 to $90,000 receives a tax subsidy of 33.5 cents for every dollar contributed by their employer;
- a middle income earner (on $20,000 to $50,000) receives just 16.5 cents; and
- a low income earner on a part-time wage (most of whom are women) receives just 2-3.5 cents.

This means that the high income-earner receives about ten times the of a low income-earner subsidy (per dollar contributed), and about twice that of a middle income-earner.

Abolishing contributions taxes would only compound this inequity:

- a high income-earner on $60,000 to $90,000 would receive a tax subsidy of 48.5 cents for every dollar contributed by their employer;
- a middle income earner (on $20,000 to $50,000) would receive 31.5 cents; and
- a low income earner on a part-time wage (most of whom are women) would receive just 17-18.5 cents.

Another inequitable feature of the present system is the inconsistent tax treatment of contributions made from before-tax earnings (employer contributions) and those made from after-tax earnings (contributions from employees and self employed people). The abolition of contributions tax would also exacerbate this problem.

The ASFA supplementary submission states that:
Submissions such as those by ACOSS are mistaken in assuming that superannuation is the preserve of the rich. The bulk of the benefit of tax concessions for superannuation contributions goes to the employed at the lower end of the income distribution.[1]

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[1] ASFA *Supplementary submission,* p18.

This statement is not supported by evidence presented by ASFA.

ASFA estimates that:
Over 60% of employer contributions to superannuation accrue to the benefit of employees with incomes less than $50,000 per annum[2].

However, it does not follow that the bulk of the value of the concessions accrues to low and middle income-earners. The reason for this is that the value of tax concessions *per dollar contributed* is much higher for high income-earners, as indicated above.

The evidence presented by ASFA is not inconsistent with our own estimate that more than half the value of tax concessions for contributions accrues to people earning over $50,000 per annum, and more than one third accrues to those earning more than $60,000.

2. Clarification of our proposed long-term savings rebate

ASFA raises a number of criticisms of our Long-term Savings Rebate proposal that reflect either a mis-understanding of the proposal or a lack of detail in our submission. We therefore clarify a number of features of the proposal. We are not wedded to the precise details of the Rebate outlined in our submission (which are illustrative) or any particular strategy to administer it. It could be designed and administered in a range of ways and Governments would be sensible to take wide advice before introducing it.

The basic proposition is that all superannuation contributions would be made from after-tax income and that tax paid on contributions would be offset (in many cases more than offset) by a refundable tax credit, which we have called a "rebate" for ease of public understanding. The tax credit would be deposited into each member's superannuation account at the end of each financial year. It would based on a proportion of contributions made during the year (in the illustrative example, 100% up to a certain level and 20% thereafter) up to a flat annual ceiling.

To clarify a number of specific aspects of the ACOSS Rebate model raised in the ASFA Supplementary Submission:

- The rebate would not be the same flat level for everyone. It would increase as contributions rise. However, it would be capped to prevent excessive subsidisation of superannuation for high income-earners and to enable the Government to redistribute tax concessions for contributions in favour of low and middle income-earners without any additional cost to revenue.

- The suggested level of the proposed cap is 3% of earnings above the SG requirement for a person on average full-time earnings. That amount is currently $5,160 (higher than the amount indicated in our submission since the SG has since risen to 9%). If the SG were increased to 12% as we propose, the cap would rise to $6,450 at current levels of average earnings. The cap could be set a higher or lower level, bearing in mind that in a revenue-neutral reform, this has implications for the level of the Rebate available to people on low incomes.

[2] ASFA *Supplementary submission,* p18.

- The vast majority of wage earners, including those wage-earners on $50,000 (the income level used ASFAs example[3]) who lack access to salary sacrifice arrangements, would be better off than under the present system, at no net cost to Government. Most individuals earning average wages or less would receive an increase in annual superannuation contributions (net of tax) of the order of $300 to $400, or 1-2% of earnings.

- The vast majority of wage earners would also have a greater incentive to save through superannuation.[4] Most wage-earners lack access to salary sacrifice arrangements and receive a tax subsidy for contributions equal to just 9% of their earnings - the SG requirement. Some also receive a very small rebate for personal contributions. The proposed Rebate gives an average wage earner scope to supplement SG contributions with an extra 3% of earnings in tax-supported voluntary contributions. A person on half-average earnings could contribute an extra 15% of earnings in tax-supported voluntary contributions.

- For every individual whose retirement income would be "eroded" by the ACOSS proposals[5], many more would be better off. The proposal would end the present concentration of the majority of tax subsidies for contributions within the top 20% or so of wage-earners.

- ASFA correctly points out that under our Rebate proposal, tax on contributions in excess of the above-mentioned cap for a person on $50,000 would be 42% (47% in the case of a person on $60,000). The Medicare Levy would also be payable. These are the current legislated marginal tax rates for individuals on those income levels. Whether they are "inequitable" is a broader tax policy issue.

- We do not consider our suggested cap on tax-subsidised contributions to be unreasonable, taking account of the highly concessional treatment of fund earnings. It is true that the proposed cap would remove tax subsidies from voluntary contributions made by many high income-earners. That is our intention: to redistribute superannuation tax subsidies to those who need them most and are most likely to need the Age Pension in retirement.

- No credible argument for subsidising voluntary contributions by high income-earners through the tax system has been advanced. To do so is wasteful since most will not rely on the Age Pension in any event, and most achieve adequate retirement incomes through a combination of superannuation and other investments.[6] There is no sound social or economic policy reason to encourage high-income earners to use voluntary superannuation contributions, as against alternative investment strategies, to top up their retirement incomes above and beyond SG levels.

- Assuming that limited tax dollars are available to subsidise superannuation, it is fairer and more efficient to redirect them in favour of the majority of fund members on low and middle incomes.

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[3] ASFA *Supplementary submission* p10.

[4] See Graph 5 in our original submission.

[5] ASFA *Supplementary submission* p12.

[6] Although a minority of wage earners earn high incomes for only a small part of their working lives, this does not render the "cap" inequitable in these cases. This group would benefit from more generous tax treatment of contributions over the majority of their working lives when their wages are lower.

- ASFA argues that high income-earners will be discouraged from investing in superannuation by the proposed Rebate system notwithstanding the retention of the 15% flat tax on fund earnings (which is actually lower when imputation credits and concessional treatment of capital gains is taken into account). This would not be a rational response. We understand that, despite lower investment returns over the short term, fund earnings will increasingly overshadow contributions as the most important contributor to growth in superannuation assets.

- Retaining the existing tax treatment of benefits *may* give rise to inequities if the capped rebate system were introduced at the contributions end. This depends on the extent to which benefits taxes are a significant factor in any event for the vast majority of superannuants.[7] We acknowledged this in response to a question from the Chair of the Committee during the hearing. One way to address this problem would be to treat contributions in excess of the annual cap described above as fully taxed, for the purpose of the tax treatment of benefits derived from such contributions. This may give rise to some complexity, but the complexity of benefits taxation would be minimised if existing "grandfathering" arrangements were simplified, as many superannuation industry commentators advocate.

- Under the proposed rebate system, *all* contributions would be taxed at the appropriate marginal tax rate, minus the rebate. ASFA has misunderstood our proposal in this regard, suggesting that marginal rates of tax would only apply to contributions made by or on behalf of wage-earners. The mechanisms by which this would be achieved are the same ones used to collect income tax generally. They include the withholding of tax from wages, the Business Activity Statement, and an annual reconciliation of income through taxation returns. The Australian Taxation Office would administer the proposed system in parallel with the mainstream income tax system.

- The withholding of tax from contributions, and the reconciliation of tax at the end of each year, would have no effect on the member's current net income. It would only effect the level of contributions to superannuation net of tax. The end-of-year reconciliation would ensure that the correct amount of tax is deducted from contributions and the correct Rebate is paid into the fund. Administration of the system for members of multiple funds should not pose an insurmountable problem. After all, the tax system has dealt with the problem of employees with multiple employers for many years. Many of the "practical" arguments against taxing superannuation contributions at marginal rates could be applied with equal force against *any form* of progressive income taxation.

- Tax could be levied on implied contributions to defined benefit funds in much the same way that it is now through the surcharge. This is a complex problem, but one that can and must be resolved to ensure that the system is fair.

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[7] There are many avenues for high income-earners to avoid any taxation on end benefits, as AFSA's response to the committee's questions on this subject reveal.

3. Retirement income benchmarks and compulsory saving

ASFA argues that the original ACOSS submission implies a retirement income target of $13,260 for singles and $19,500 for couples, and that this target is too austere. It also argues that the current Superannuation Guarantee, together with the Age Pension will provide only a modest standard of living in retirement for most people.

Nowhere in our submission do we advocate adoption of the SPRCs *modest but adequate* income levels ($13,260 for singles and $19,500 for couples) as a retirement income target. Like NATSEM in the study quoted by ACOSS, we simply use these figures as a common benchmark for comparing the absolute living standards achieved by different groups.

Our assessment of the appropriate level of compulsory saving for retirement is not based on a stand-alone retirement income benchmark. This is not because retirement income adequacy is unimportant. Rather, compulsory saving policies must take pre-retirement living standards into account. Compulsory saving targets should be based on the *relative living standards* of low and middle income-people before and after retirement.

The purpose of saving is to forego consumption at one stage of the life cycle in order to raise it later on. It makes no sense to compel people to save to attain a higher living standard in retirement than over their working lives.

The Superannuation Guarantee (SG) should be sufficient to deliver a retirement income for low and middle-income earners that is somewhat less than 100% of average pre-retirement living standards. On this basis, we argue that 9% of earnings overshoots the mark, at least with regard to low income-earners.

The main reason that retirement incomes obtained from SG contributions are modest in most cases is that most people's *pre-retirement incomes* are very modest. For example, in 1999-2000, if we set aside the bottom 20% of families with children whose main income source was Government benefits, approximately 11% of families with children had gross incomes below $30,000 and 38% had gross incomes below $50,000.[8]

Low-income families struggle to survive and many middle-income families struggle to meet home loan commitments and raise their children. Forcing them to forego more of their current income (or future wage increases) to boost their retirement incomes will push many more into hardship.

The solution to this dilemma is not to abandon compulsory saving. It is to broaden the purpose of compulsory saving to address these and other long-term savings needs in a flexible and non-prescriptive way.

Our policy focus on comparing *pre-and-post retirement living standards* leads us to the NATSEM study. This is the first Australian research to take proper account of the fall in *living costs* after retirement. Since this is a new field of research and the study only deals with a limited number of "cameos" rather then the full population, it does not offer conclusive evidence on the appropriate level of compulsory saving for retirement. Nevertheless, it is a major advance on all previous research, the results are strong, and they speak for themselves:

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[8] ABS, *Income distribution (1999-2000).*

- Single people on low and middle incomes who receive SG contributions over 40 years attain a living standard in retirement in excess of 100% of their average pre-retirement standard.

- Low and middle income couples with two children (in which one partner receives SG contributions over 40 years and the other withdraws from the labour force to raise a child and then works part time before returning to full-time employment), also attain a living standard in retirement in excess of 100% of their average pre-retirement standard.

- The only groups modelled in this study that do not achieve this standard over 40 years of employment are childless couples and high income-earners, who are generally in the strongest position to save voluntarily for retirement.

ASFA challenges the Treasury's "assumption" of 40 years of continuous employment. In our submission and in response to the Committee's questions we noted that:

- the average overall duration of employment for males is approximately 40 years at present, and this will gradually increase;

- most mothers (that is, the women with the lowest employment durations) retire as members of a couple whose average living standards in retirement (when compared with their pre-retirement living standards) are comparable to those of single men and women in the NATSEM study.

- separated mothers often face severe hardship as they raise their children, and most are in no position to save more for their retirement.

4. Clarification of our proposed lifelong savings system

ASFA has also misunderstood our Lifelong Savings proposal.

ASFA is critical of the fact that we do not provide projections of the effects of our Lifelong Saving system on future retirement incomes. We would welcome attempts to model the proposal by the Committee or the Treasury, as this is a complex task beyond our current resource capacity.

We believe, however, that our reform package when considered as a whole would *increase* retirement benefits for most middle income-earners, compared with the present superannuation system. It could reduce benefits slightly for many low income-earners (because the flat-dollar cap on pre-retirement benefits represents a higher proportion of their savings). However, we argue that this is not an undesirable outcome since the SG overshoots the mark in regard to people on low incomes. Further, low income-earners have the greatest need for flexibility to address long-term savings needs other than retirement.

Moreover, any reduction in superannuation benefits arising from pre-retirement withdrawals would be offset to a large extent (in the case of low and middle-income earners), by higher Age Pension payments. This is clear from RIM Group's modelling of the REIA proposals to make superannuation benefits available for first home purchase.[9]

ASFA focusses on our proposal to allow fund members to withdraw part of their superannuation benefits before retirement. They have not paid sufficient attention to the following features of our proposed superannuation reform package that either limit or offset any reduction in retirement benefits:

- the increase in compulsory saving levels from 9% to 12% of earnings;
- the limits on pre-retirement withdrawals, including a cap of one third of benefits for any single withdrawal, a lifetime cap on pre-retirement benefits of a flat $50,000 (indexed), and restrictions as to the timing of withdrawals (for example, that none can be made within the first five years), which taken together would significantly restrict pre-retirement withdrawals by middle and high income-earners;
- the more rapid increase in the preservation age for retirement benefits to 60 years[10];
- the stricter ($100,000, indexed) limit on lump sum benefits, including the proposed dollar for dollar offset of any pre-retirement benefits against this amount;
- the higher tax subsidies for contributions by low and middle income-earners.

Further, we propose that a simple set of transitional arrangements be put into place to avoid excessive use of the existing (pre-reform) stock of superannuation savings for non-retirement purposes.

Allowing people to draw down part of their superannuation benefits for non-retirement purposes and boosting tax concessions for low and middle income-earners would broaden public support for these necessary but politically difficult reforms.

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[9] See Treasury (1997), *Allowing access to superannuation for housing*. This implies a higher cost to Government, but this additional retirement income subsidy would be well targeted towards those who need it most, given the pension income test and our proposed flat $50,000 cap on pre-retirement benefits.

[10] We have not advocated a specific timetable for this reform. For illustrative purposes, this measure could be phased in over the next 10 years.

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