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Fiscal Group  
Budget Policy Division  
Department of the Treasury  
Langton Crescent  
PARKES ACT 2600

By email: [prebudgetsubs@treasury.gov.au](mailto:prebudgetsubs@treasury.gov.au)

Dear Treasury,

## Pre-Budget Submission – Improving superannuation

Rice Warner is pleased to provide this submission which sets out some ideas for improving equity and gaining simplicity in our superannuation system.

We are conscious that superannuation is a major component of the Tax White Paper review and that the government may not be ready to make significant changes in the current Budget. Nonetheless, we have set out what we consider to be rational changes which could be made immediately.

## About Rice Warner

Rice Warner is a trusted partner to many successful organisations operating in Australia's dynamic financial services sector. Our valued clients include superannuation funds, financial institutions, fund managers, life insurers, administrators, financial planning licensees and providers of financial software. These clients seek our consulting advice, research on products and markets, as well as our financial technology services.

Since 1987, our firm has built an unrivalled reputation for providing fact-based guidance to industry participants. Rice Warner has a rich heritage of independence and informed opinion leadership. This derives from our culture backed by our actuarial roots and unique research across the superannuation, wealth management and life insurance sectors.

Our unique insights, partly generated from our rich databases, help clients to develop effective commercial strategies and operational tactics. This also underpins Rice Warner's renowned public policy and research activities. The media, industry bodies and policy makers source from Rice Warner our unbiased opinion, research and industry projections.

Since 2007, Rice Warner has built a strong and growing digital capability leveraging financial technology. An example is the support we provide to financial advice firms and others requiring member/customer education tools and software.

Leveraging our rich industry knowledge and actuarial skills, our FinTech offer includes a unique range of client services, designed to meet increasing market demand for intelligent and efficient technology solutions.

Our team of dedicated consultants, who have been selected because of their diverse backgrounds and skills, are committed to working collaboratively with each client to improve their capacity to compete and sustain their market position.

Many of our consultants regularly participate on industry body committees and working groups, including the Actuaries Institute and ASFA. This allows us to stay abreast of emerging and current issues and trends that may impact our clients.

Further information about our business is available on our website ([www.ricewarner.com](http://www.ricewarner.com)) or can be supplied on request.

## 2015 Pre-Budget submission

In our pre-Budget submission last year, we suggested three initiatives which are all still valid, namely:

- Consider allowing superannuation funds to offer an option of a joint superannuation account for couples
- Allow employers to pay additional superannuation contributions for their female employees<sup>1</sup>
- Remove the \$450 a month threshold under which SG contributions do not need to be paid

We consider Treasury should consider these recommendations.

## Rice Warner submission on tax reform

We have set out some of the arguments for reform in our submission to the tax White Paper task force <http://ricewarner.com/wp-content/uploads/2015/07/Tax-White-Paper.pdf>. The executive summary of this document is included as an attachment to this letter.

As you can see, we have considered changes which would make superannuation more equitable and affordable for government. Further, if these changes are made, it will allow the Superannuation Guarantee rate to rise from 9.5% to 12% without becoming an undue fiscal burden. This rise is necessary to ensure more Australians become financially secure in their retirement years. As superannuation funds collectively deliver long-term returns in excess of wage growth and GDP growth, it is economically sensible to pre-fund retirement benefits wherever possible. The accumulation of mandatory employer contributions over the last 30 years has been the strength of the Australian superannuation system.

In summary, we suggest the following changes which could be introduced in the Budget:

- Imposing a lifetime cap on non-concessional contributions of \$500,000. This is a considerable reduction from the current allowance of \$180,000 a year.
- Reduce the current level of minimum withdrawal values by 25% to 50% to allow members to defer drawdowns during periods of market downturns. Deferral of withdrawals will assist the retirement benefit to last for a longer period during retirement.
- Change the tax rate payable on the death of a pensioner (without dependants) to be a flat 15% plus Medicare giving 17% in total. This would eliminate re-contribution strategies which simply avoid tax.
- Consider changing the Transition to Retirement pension structure as these favour high income earners even though they were intended to help middle-income Australians 'catch up' their superannuation later in their careers.

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<sup>1</sup> We have sent a detailed submission about this and other relevant matters to the Senate Economics References Committee for its inquiry into the *Economic Security for Women in Retirement*.

The following changes could be introduced as part of the broader tax reform package:

- Having a uniform tax rate on the earnings of accumulation and pension accounts. A rate of about 10.5% would provide revenue neutrality. We recommend a rate of 12% which would help workers to grow their benefits faster from a lower tax rate than the current 15%.


Pensioners would pay tax on earnings but 12% is still a highly concessional rate. Further, the bulk of the tax would be borne by those with large benefits.

- We recommend a 20% rebate on marginal tax rates for concessional contributions. This would be more equitable than the current rules which effectively give tax relief at the marginal tax rates less 15%. Consequently, the current rules favour high income earners by giving tax relief of 34% of concessional contributions. Those on modest incomes receive little tax support and are penalised where their marginal tax rate is less than 15%.

We consider this should be introduced in conjunction with a reduction in personal tax rates. Such a change would eliminate the need for the lifetime cap on concessional contributions which is favoured by some in the industry.

We would be pleased to discuss our analysis with Treasury.

Yours sincerely,



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CEO & Authorised Representative  
Rice Warner Pty Ltd AFSL 239 191

## Rice Warner submission to tax white paper task force

### Executive Summary of submission

#### Focus of this submission

This submission specifically addresses Question 22 of the Tax Discussion Paper, namely:

***How appropriate are the tax arrangements for superannuation in terms of their fairness and complexity? How could they be improved?***

It looks at the effectiveness of the three pillar structure of superannuation comprising the Age Pension, mandatory employer contributions (superannuation guarantee) and voluntary contributions.

We note the size of tax concessions provided on contributions and earnings as well as the growing expenditure on Age Pensions. We comment on whether the tax concessions are well targeted and whether they will reduce dependence on welfare benefits for the retired population.

In our opinion, the current structure fails some of the Principles set out by the task force regarding equity, efficiency and simplicity. We show what changes are required to meet these Principles. This occurs because superannuation suffers from political confrontation which is a barrier to effective policy.

We have limited our analysis to the retirement system but we note that the share of personal taxation has risen to 48% of the \$415b of revenue expected to be raised in 2015-16. We expect this will need to be reduced in future years though the Discussion Paper suggests the share of personal taxes will continue to grow.

We suggest the top marginal tax rate should be lowered in time to no more than 40 cents in the dollar. It is well known that tax rates are not efficient nor internationally competitive at the current level of 47% (including Medicare levy) or 49% if we also include the Temporary Budget Repair Levy.

If the top marginal rate is reduced, the cost of superannuation concessions will reduce since the concession will be lower. We have noted this when costing our suggested improvements.

### Purpose of Superannuation

#### Systemic issues

The main reason for having a superannuation system is to encourage people to become self-sufficient in retirement.

The system has many well-known issues:

- The Age Pension is neither a safety net nor a universal benefit since Australia has a unique system of means-testing its State benefit. This makes it difficult for workers to plan for retirement, given the majority will receive a full or part Age Pension during their retirement.
- The means tests for the Age Pension exclude the value of the family home. This favours home owners over renters. It also creates anomalies between different home owners. A couple with a home worth \$500,000 and \$1.25 million of financial assets would receive no Age Pension. In contrast, a couple with a \$3 million home and minimal financial assets would receive a full Age Pension, at the expense of

taxpayers in much less fortunate situations. Further, as Australia has limited death duties, the family home is passed tax-free on death in retirement. This could occur even if a married couple receives a full Age Pension throughout retirement – and this is worth more than \$800,000.

- Taxation has a complex basis. Superannuation funds are taxed on contributions and earnings and this reduces the end benefits members will receive. In contrast, most earnings and benefits received after age 60 are tax-free.
- Tax concessions are generally agreed to be inequitable even though they are changed by government frequently.
- Default investment strategies in the working years are world-class. However, there are no defaults in the retirement phase and the interaction between superannuation, taxation and the Age Pension is complex.

## Principles

The recent Financial System Inquiry suggested the following objective for superannuation:

*“To provide income in retirement to substitute or supplement the Age Pension”*

This statement precludes the use of superannuation for purposes other than providing retirement incomes. There is already one major diversion of retirement savings for the provision of insurance within superannuation. This is worthwhile as it has greatly enhanced the level of life and disability cover within the community at a reasonable cost. We would suggest that the value of sustaining this insurance framework should be recognised in setting objectives for the system.

Some commentators have suggested that funds be used for a variety of other purposes including:

- assisting young people to meet deposits on house mortgages
- paying for health costs in the retirement years
- funding Aged Care facilities late in life

As we know that projected superannuation benefits will be inadequate to deliver a comfortable lifestyle in retirement for many members, it is not practical to extend the use of superannuation to these other purposes.

## Goals

The superannuation system would be more highly regarded if the population accepted that it was:

- Fair and equitable
- Sustainable for government
- Simple for members to understand and use
- Providing reasonable benefits in retirement
- More certain about the rules with far less annual change (which is seen as tinkering)

A review of superannuation taxation and integration with the Age Pension is needed. Changes can be made which will improve all the above goals.

## Philosophy of providing tax concessions

We know that most people would not naturally be inclined to save for retirement until quite late in life. Consequently, tax concessions are an encouragement for workers to save earlier. Early savings also generate higher benefits due to the compounding effect of earnings.

The arguments for tax concessions are:

- Australia has a high, mandatory savings rate required for retirement benefits (currently 9.5% and rising to 12%). There should be a reasonable reward for locking up this deferred pay for decades.
- Benefits are inaccessible (except under some limited conditions) until the member reaches Preservation Age (between 55 and 60). For many young members in the workforce, this period could be in excess of 40 years.
- The concessions reward and compensate participants in the superannuation system for foregoing their take home pay to provide income for their own retirement and not be totally reliant on the government Age Pension. Therefore, the government should benefit from reduced future welfare payments.
- Tax concessions encourage additional savings through voluntary contributions (Pillar 3)
- Without tax concessions, there would be no reason for Australians to put aside additional savings specifically for the purpose of retirement savings. Most savings would shift to unregulated investment vehicles which would place people at higher risks.
- This encourages planning for retirement over other use of disposable income. This means benefits grow at a faster rate during the accumulation phase.

## Structure of superannuation

Section three of this submission reviews the structure and costs of providing Australian superannuation.

The key observations are:

- The Three Pillar structure and the taxation of superannuation are complex. It is confusing for members and retirees.
- Retirees take on all risks as there is little mortality pooling. The main reason for this is the absence of suitable products. There are lifetime immediate annuities available but they deliver poor value if purchased at the time of retirement.
- Retirees are sensible about using their superannuation benefits wisely. More than 90% of superannuation benefits (measured by assets) are converted into retirement savings and are not consumed at the time of retirement.
- The cost of providing tax concessions to superannuation funds is growing and needs to be curtailed. The longer this is delayed, the more severe the adjustments that would ultimately be needed.
- The tax concessions are not well targeted. The concessions are tilted towards the well-off and the projection of retirees who will be self-sufficient in later years will still be relatively low (less than 30% in 40 years according to the latest Intergenerational Report – and some of these will be working rather than retired).
- Superannuation funds will pay tax of about \$8 billion this year and this will grow in future years.
- The cost of providing Age Pension benefits is also growing but is affordable
- Integration of the Age Pension and superannuation is poor. Consequently, the Age Pension has the dual roles of providing a safety net for the poor and a benefit entitlement for the bulk of retirees.

## **Taxing superannuation**

### ***Taxing earnings***

We recommend having a uniform tax rate of 12% across the earnings of accumulation and pension accounts. The current rate is 15% on accumulation accounts and nil on pension accounts.

We suggest a rate of 12% of earnings, though a lower rate of 10.5% would provide revenue equality.

The application of this change has many benefits which are set out in section 4.2.1

### ***Concessional Contributions***

We agree with the logical solution of the Henry tax review to make the deductions fairer by equating the tax benefit to all personal income tax payers. We suggest a uniform 20% rebate be allowed on concessional contributions. This would reduce the benefit for a high income earner from 49% (including Medicare Levy and Budget Deficit Repair Levy) to 20%.

At this level of concession, it would be possible to increase the allowable concessional contributions from \$35,000 to (say) \$50,000 a year. This higher limit would be useful for people who wanted to top-up their superannuation by making larger payments later in life when they have the ability to do so.

In order to simplify administration, we would change the collection basis of the tax. Rather than tax contributions at 15% in the fund, we would tax them in the personal tax return of the member. This would also have the benefit of increasing the value of the SG contribution from 8.1% (after tax) to 9.5%, which will increase superannuation savings.

Low income people would receive a tax credit through the rebate system.

### ***Non-concessional contributions***

At present, the limit for non-concessional contributions is \$180,000 a year. We propose imposing a lifetime cap of (say) \$500,000 on non-concessional contributions from any source.

### ***Benefit components***

Once contributions are in a fund, we believe the difference in components (pre-83, concessional, non-concessional) should disappear. Any tax on benefits should not vary according to the source of contribution.

### ***Withdrawals during pension phase***

We recommend removing the distinction between lump sums and pensions. Once a member has attained the pension age, they simply start drawing their tax-free pension.

The current levels of minimum withdrawal values should be cut by 25% or 50% to allow retirees to hold their superannuation for longer periods, recognising that life expectancies have increased since the current factors were decided.

We recommend reintroducing maximum withdrawal factors for account-based pensions so that the pension benefits are not spent too quickly. An appropriate level might be three percentage points above the minimum withdrawal factor. The factor would be 7% up to age 65 then 8% until age 74.



We would allow superannuation fund members to draw up to (say) \$100,000 in any year even if this exceeds the maximum under the factors. This would be the proxy for lump sum withdrawals. Further, pensions could be commuted to pay for entry into an aged care facility.

Some commentators have suggested that large pension benefits should be taxed. It would be reasonable to include any withdrawal above (say) \$100,000 a year in the retiree's personal assessable income.

### **Benefits tax - death on pension**

At present, the death benefit on a residual pension benefit not left to a dependant is 17% (15% plus 2% Medicare Levy). However, the actual tax rate is much lower due to so-called re-contribution strategies. These are widely used for the sole purpose of reducing tax on future death.

This structure could be disallowed simply by taxing the full death benefit at 17% irrespective of the source of contributions. A variation would be to allow the benefit to be transferred tax-free into the superannuation (or pension) account of close family members (spouse, siblings, children or grand-children) free of any tax.

### **Social Security – The Age Pension**

We believe the part Age Pension should be phased out. Retirees should first spend their own assets and be eligible for a full Age Pension when they fall below a threshold.

We suggest that retirees should be allowed some exempt assets. It would be appropriate for a couple to keep the family home up to a value of \$1.5m and all other assets (including superannuation) up to about \$500,000. If they have assets above this, they cannot claim the Age Pension. This still favours home owners over renters so you might allow higher levels of assets for renters to compensate. This level of exempt asset would move some people currently on a part pension to a full pension and others to no pension (though we favour grandfathering of the current retirees for at least a decade).

If people run out of income but still have a valuable home, they have the choice of downsizing or requesting a government pension which will be paid as a loan with the home as security. At present, people won't downsize as the cash generated impacts on their Age Pension.

We also suggest two measures to correct the current incentives to run down funds quickly and fall back on the Age Pension:

- Retirees should be able to receive a Health Card irrespective of their financial assets from a specified age, say 75. This would remedy the current situation where linkage of eligibility for the Health Card with being on the Age Pension acts as a powerful incentive for retirees to manage their affairs in a way that makes them eligible for at least a Part Pension.
- Retirees beyond an advanced age, for example age 90 (the age to which about 25% of retirees will survive), should be able to receive the full Age Pension without means testing. This would incentivise retirees to spread their retirement savings over longer periods and help to counteract the pressures in the opposite direction that are inherent in any means testing system. The eligibility age should be linked to changes in life expectancy so that it can be adjusted as needed to keep the benefit sustainable.

### **Other changes**

#### **Franking credits**

We consider that franking credits provide an incentive for superannuation funds to invest in the Australian economy, both in listed and unlisted entities.



Removing franking credits would put equity investments at a disadvantage to debt investments. This could encourage investment into lower yielding portfolios which would lead to lower retirement incomes for the population and a greater call on the Age Pension. It could also tilt capital structures towards a higher proportion of debt capital, potentially increasing the rate of failure of business, especially in times of financial crisis.

## Guaranteed retirement products

We have suggested that pension earnings be taxed at the same rate as accumulation earnings, say 12%. It would be possible to leave immediate and deferred lifetime annuities tax free above age 60 to provide an advantage to offset the high cost of these products. However, on balance, we believe all products should have the same rate of tax and this concession should not be provided.

## Joint accounts for couples

We have canvassed the possibility of superannuation funds holding joint accounts for married couples. This already happens in the SMSF segment as about 85% of SMSF funds are run for a married couple<sup>2</sup>.

Joint accounts should lead to reduced fees, higher levels of engagement and higher levels of adequacy.

Although it is not a tax issue, we believe joint super accounts for married couples will also make the system simpler and easier to understand.

## Cost of proposed changes

We have costed the impact of making changes to contributions tax, earnings tax and the abolishment of part pensions. The results of this costing are given in Table 1 and Table 2.

We would hope that the top marginal tax rate could be lowered to 40% (including Medicare levy) and the cost of the concessions would then reduce significantly. We have modelled the results including a reduction in the top marginal tax rate to 40% in the 'combined policies' scenario.

The results show a government saving of \$6b in the first year rising to \$59b in 2055 at today's prices.

**Table 1. Policy costings – 2014-15 FY**

Policy option	Additional contributions tax	Additional earnings tax	Reduction in Age Pension <sup>^</sup>	Total Savings
	(\$m)			
Reform contributions tax (marginal less 20% rebate) <sup>#</sup>	6,587	(17)	0	6,569
Reform earnings tax (12% flat)	0	390	0	390
Abolish part pensions	0	0	0	0
Combined policies*	5,696	377	0	6,074

<sup>2</sup> According to research from the SMSF Association

\*components may not add due to interaction effects

^there is no immediate effect on the Age Pension given the recommended grandfathering arrangements

#Contributions tax is paid outside superannuation

**Table 2. Policy costings – 2055 (in 2014-15 Prices)**

Policy option	Additional contributions tax	Additional earnings tax	Reduction in Age Pension <sup>^</sup>	Total Savings
	(\$m)			
Reform contributions tax (marginal less 20% rebate) <sup>#</sup>	3,138	4,361	(605)	<b>6,894</b>
Reform earnings tax (12% flat)	0	6,575	(1,636)	<b>4,939</b>
Abolish part pensions	0	0	51,908	<b>51,908</b>
Combined policies*	<b>3,138</b>	<b>6,098</b>	<b>50,248</b>	<b>59,484</b>

\*components may not add due to interaction effects

#Contributions tax is paid outside superannuation

## Timing

We consider that most changes could be done at short notice. However, the removal of part Age Pensions would need time to implement. We suggest that there be a three year notice period so that people about to retire do not have their plans disrupted.

We consider that grandfathering existing arrangements adds to future complexity and should generally be avoided. However, we expect that existing retirees receiving a part Age Pension would continue for a longer period until a transition plan can be developed and worked through.