AUSTRALIAN CHAMBER
OF COMMERCE AND INDUSTRY

Simpler Superannuation

ACCI Submission to the Senate Economics Committee

January 2007

1. BACKGROUND

The Australian Chamber of Commerce and Industry (ACCI) has been the peak council of Australian business associations for over 100 years.

ACCI is Australia's largest and most representative business association.

Through our membership, ACCI represents over 350,000 businesses nationwide, including:

- Australia's top 100 companies
- Over 55,000 medium sized enterprises employing 20 to 100 people
- Over 280,000 smaller enterprises employing less than 20 people

These businesses collectively employ over 4 million people.

ACCI's 37 member organisations include the State and Territory Chambers of Commerce and Australia's leading national employer and industry associations. Our members represent all major sectors of Australian industry including small employers and sole traders as well as medium and larger businesses.

A list of ACCI members is attached.

2. SUMMARY

The Government has proposed a plan of substantial simplification and streamlining for superannuation. The main component of this plan is the abolition of most taxes on the payment of superannuation benefits. The simplification under the plan is laudable and addresses one of ACCI's major concerns with the current superannuation system.

We particularly support the change that makes all employer super contributions deductible to the employer.

Other changes we particularly support include:

- The reduction in the pension assets test; and
- Allowing the self employed to obtain full deductibility for contributions.

At a meeting of ACCI's Council in July, ACCI adopted the following motion:

> ACCI Council:
>
> - welcomes the Government's plans to simplify superannuation by abolishing most taxes on benefits;
> - notes that the long-term costs of this change have not been estimated; and
> - indicates qualified support for the proposal, conditional upon the changes being fiscally sustainable.

ACCI therefore supports the Government's plan as long as it is fiscally sustainable. It is not clear whether this is correct. If the costs are large, it is possible that the plan will mean the deferral or cancellation of tax reforms that ACCI considers to be a greater priority.

Therefore, ACCI urges the Government to develop a long-term cost of the plan. This would be consistent with the Government's own Charter of Budget Honesty and recommendations of the IMF.

Arguments that the Government cannot do long-term revenue costings are without foundation and it is very surprising that the Government makes policy decisions that have a long-term effect without measuring that effect.

The Government's plan will mean significant simplifications of the superannuation system, which will mean individuals have much better understanding of their super needs. This will mean greater investment in superannuation, particularly when combined with the lower taxes on super. However, some of the extra saving put into superannuation could come from other savings vehicles.

The Government's plan will reduce marginal tax rates on many older people, meaning some will increase their labour force participation. However, some others may reduce participation because of the extra income they receive under the Government's plan. The net effect of these two forces is uncertain.

There are a number of concerns with the Government's plan including:

- It may encourage double dipping, by removing the incentives for retirees to take lump sums rather than income streams (private pensions).
- The plan may encourage tax avoidance.

ACCI encourages the Government to develop and release a long term costing of this plan to determine whether these concerns are genuine problems.

On details of the Government's plan, ACCI recommends that:

- The Government should explore whether the rules for contributions by employees and the self-employed could be simplified.
- The Government should address concerns about the quotation of Tax File Numbers (TFNs) without imposing extra burdens on employers.

3. BACKGROUND

The Government released a detailed plan to simplify and streamline superannuation on 9 May 2006.

The details include:

- Superannuation benefits will be tax free for people aged 60 and over, as long as the benefits come from a taxed super fund.
- Benefits paid by untaxed funds, or to people aged under 60 will continue to be taxed but at a lower rate.
- Reasonable Benefits Limits will be abolished.

- The age-based contribution limits will be streamlined. The maximum contribution from untaxed sources will be $50,000 and the maximum contribution from taxed sources will be $150,000.
- There will be special transitional rules for the next few years to allow people nearing retirement to make larger contributions.
- The pension assets taper rate will be reduced. For every $1,000 of assets, pensioners currently lose $3 of pension per fortnight. This will be reduced to $1.50.

The plan will cost of $6.2bn over the four years to 2009-10. The full details on the plan are available at: http://simplersuper.treasury.gov.au/

The Senate Economics Committee is examining the legislation to implement this plan. This submission is in response to that inquiry for comments.

4. ACCI Policy

The simplification under the plan is laudable and addresses one of ACCI's major concerns with the current superannuation system.

We particularly support the change that makes all employer super contributions deductible to the employer.

Other changes we particularly support include:

- The reduction in the pension assets test; and
- Allowing the self employed to obtain full deductibility for contributions.

At a meeting of ACCI's Council in July, ACCI adopted the following motion:

> ACCI Council:
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> - welcomes the Government's plans to simplify superannuation by abolishing most taxes on benefits;
> - notes that the long-term costs of this change have not been estimated; and
> - indicates qualified support for the proposal, conditional upon the changes being fiscally sustainable.

ACCI will therefore support the Government's plan as long as it is fiscally sustainable. The evidence on this is not clear yet.

4.1. Comparison with ACCI's policy

4.1.1. ACCI's Taxation Reform Blueprint

In our *Taxation Reform Blueprint*, released in 2004, ACCI supported the gradual reduction of superannuation contributions taxes, replacing with equivalent tax levels on benefits.

The Government's plan moves in the other direction, removing taxes on benefits while retaining taxes on contributions.

The other main difference with the Government's plan is that it increases the tax concessionality of the superannuation system whereas ACCI's Blueprint supported keeping the overall tax levels the same. The Blueprint argued that the greater priorities for tax reductions included reducing the top marginal tax rate closer to the company tax rate, indexing tax thresholds and reducing the burden of Capital Gains Tax (CGT).

It is possible that the Government's superannuation plan makes tax reform in ACCI's priority areas less likely.

That said, ACCI is not opposing the Government's plan mainly because it addresses ACCI's main concern with superannuation, which is that it is too complex.

4.1.2. Advantages of removing contributions taxes

ACCI is disappointed that the Government dismissed the option of replacing contributions taxes with equivalent benefits taxes. ACCI's preferred option would have had a number of advantages including:

- It would defer Government tax revenues to when these revenues are most needed – when people are retiring. This would offset some or all of the fiscal gap created by the ageing of the population.
- Tax imposed on benefits is more equitable, because it can reflect lifetime contributions. Equity can be addressed through a progressive benefits tax. A progressive contributions tax is much less equitable and can be very complex (see the experience with the superannuation surcharge).
- It would move the taxation of superannuation towards an expenditure tax, which is the general direction of tax around the world (in many countries, taxes on incomes are being reduced while taxes on consumption or expenditure are being increased).
- It would allow some difference in the tax treatment of lump sums and income streams to be maintained.
- It would allow the abolition of contribution limits, which are inequitable for those with fluctuating incomes and also disadvantage those who fail to plan early for retirement.

The Government argues that removing the contributions tax would increase complexity, because the benefits tax would have to differ depending upon whether the contribution was made before or after the contributions tax was removed.

However, it does not appear that the Government adequately explored the option of introducing a single tax on benefits for all, with the Government then making contributions into individual accounts so that no one was worse off[1].

1. In other words, ungrandfather all of the different tax treatments of benefits and provide compensation for all those who would lose from this change.

Making contributions to individual superannuation accounts would be a much better investment than the Future Fund. ACCI considers the Future Fund to be bad policy – for more details see our submission to the Senate inquiry into the Future Fund Bill, available from our website www.acci.asn.au

In the Government's summary of its plan, it explains why it chose not to remove the tax on contributions[2]. It argues that:

- the removal of the contributions tax would only increase retirement incomes by a small amount, compared to the Government's plan; and
- the removal of the contributions tax *and* the reforms to the pensions test will cost more than the Government's plan.

The Government is not comparing like with like. When it argues that the benefits to individuals are small, it does not include the changes to the pension test; but when it says the budget costs are large it does include the changes to the pension test. This comparison is unhelpful.

Therefore, comparisons with the removal of contributions tax should always include the changes to the pension test.

It is not clear if the allegedly high cost of removing the contributions tax was a short or long term cost. If it is a long run cost, this contradicts other arguments by Treasury that long-term costs are not able to be estimated – see below.

5. Long Term Costs

ACCI is disappointed that the Government has essentially rejected all requests for long term costing of this plan. As previously indicated, ACCI supports the Government's plan as long as it is fiscally sustainable. We are unable to determine the plan's sustainability without these costings.

As a consequence, the Government could be acting inconsistently with the Charter of Budget Honesty Act 1998, which states that the Government should "ensure that policy decisions consider their financial effect on future generations."[3]

ACCI notes that the International Monetary Fund (IMF) has called for long-term costing of the Government's superannuation plans in its latest survey of Australia. The IMF "agreed that the proposed reform would increase labor participation among older workers, and encouraged the authorities to provide an assessment of the net longrun fiscal impact of the proposal." (page 11).

5.1. Public comments on costing

There are a number of private sector estimates of the cost of the plan. It is hard to reconcile these figures:

2. Commonwealth Government (2006) *A plan to simplify and streamline superannuation* at pages 8-9.
3. Intergenerational Report (2002), page 16.

- The Institute of Actuaries argues that the plan will cost around 0.33 percent of GDP per year by 2040[4].
- Access Economics argues the changes will cost about 1.5 percent of GDP by 2040 or $12 billion per year, five times the cost today[5].
- John Head, professor in the Taxation Law and Policy Research Institute at Monash University, argues the cost could reach $10 billion per year by 2020[6].

In addition, the Secretary to the Treasury, Dr Ken Henry, has argued that the costs of the plan are less than the costs of the 2006 personal tax cuts[7], although it is not clear over what timeframe this comparison is made.

5.2. Ability to do long-term costs

Treasury has argued that it is unable to do long-term costing of revenue measures, because it has no long-term model of tax revenues to compare policy changes against.

The essential problem is that tax revenues will grow forever if there are no policy changes because of bracket creep or fiscal drag, which occurs when taxpayers' average and marginal tax rates increase because tax thresholds are not indexed to wages or inflation.

To deal with this problem, the Government assumed in the 2002 Intergenerational Report (IGR) that future Governments would adopt the policy of maintaining Government revenue constant as a share of GDP. This could be seen as being the 'base case' to compare policy changes against.

This is a rather weak assumption, as it does not take account of the effects of demographic changes on tax revenues – for example, an ageing population means greater expenditure on health, leading to lower GST revenue (most health expenditures are GST-free).

The lack of robust modelling on revenue in the IGR means that it tells only half the story and may present a misleading picture of the state of the Budget in future years. It is inconsistent to assume that the Government will always act to ensure that tax remains constant as a proportion of GDP but they won't do this for expenditure.

Therefore, a better model would be to make relevant assumptions for each tax base – for personal tax the appropriate assumption would be that the tax scales are indexed to wages growth (indeed it would be even better if personal tax scales actually were indexed to wages growth or a similar measure).

Making this assumption would allow estimates of the long term effect of revenue proposals to be assessed.

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4. Institute of Actuaries of Australia (2006) "Media Release – Tax-free Superannuation Benefits will not lead to a Future Revenue Problem", 13 July.
5. Kerr (2006) "Changes to super will bite taxpayers" *The Australian*, 2 June.
6. Head (2006) "Super cuts to cost dearly" *Australian Financial Review*, 29 May.
7. Hansard of Senate Economics Committee, Estimates, 1 June 2006, page 73.

ACCI's support for the Government's proposal is conditional upon it being fiscally sustainable. Modelling of the long-term effects is essential to meet this condition.

It is surprising that the Government has not developed a model for long term revenue costings. These costings are surely fundamental to many policy debates and it is unfortunate that the Government makes policy decisions with long-term effect without measuring that effect.

It could also be argued that a lack of revenue modelling in the IGR is inconsistent with the Charter of Budget Honesty Act 1998, which argues "An intergenerational report is to assess the long term sustainability of current Government policies over the 40 years following the release of the report, including by taking account of the financial implications of demographic change."[8]

6. Benefits of the Government proposal

Notwithstanding the criticisms of the Government's proposals contained elsewhere in this submission, there are a number of very important benefits from the proposal that ACCI welcomes.

6.1. Simplification

The Government's proposal will mean a very substantial simplification of the superannuation system. These simplifications include:

- The removal of the complex grandfathering provisions for benefits taxes
- The removal of reasonable benefits limits
- The abolition of forced payments of benefits and work tests for contributions
- The simplification of benefits taxes for those aged under 60
- The removal of age-based contribution limits (although the transitional rules are complex)
- Simpler tax rules for contributions

We particularly welcome the decision to allow employers deductions for all super contributions, removing the tests for deductibility.

The simplification of superannuation will mean that individuals have a much greater ability to understand their superannuation. It will be much easier to calculate retirement incomes and therefore plan for retirement. To the extent that individuals recognise that their retirement incomes are inadequate, the Government's plan will result in higher retirement saving. It is likely that under the old system, individuals either had to incur a significant cost to get advice on planning for retirement or just did not plan for retirement at all.

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8. Intergenerational Report (2002), page iii.

Simplification will also mean reduced costs on individuals and business. The compliance costs from a complex superannuation system were unnecessarily large.

Business has been concerned about overregulation for some time. The Government's plan goes some way towards reducing excessive regulation.

Note that ACCI's preferred policy of replacing the contributions tax with equivalent levels of benefits tax could also be designed to make the system simpler, see discussion in Section 4 above.

6.2. Saving

The Government's plan is very likely to increase saving through superannuation.

However, it is not clear that the plan will cause an overall increase in saving, because individuals may just switch from other savings (such as bank accounts, shares and housing) into superannuation.

For retirees, the reduction in the pension assets test will substantially reduce the incentives for retirees to dissave.

We note that the Government has not modelled this effect.

6.3. Labour force participation

Many commentators recognise that it is important to encourage labour force participation. This is for a number of reasons, including:

- Improving the income and wellbeing of the disadvantaged (non-employment is associated with many indicators of disadvantage, such as higher income inequality, crime, poor health outcomes, suicide and reduced life satisfaction);
- Ensuring Australia's productive potential is maximised;
- Reducing wages pressures that would otherwise occur when unemployment levels are low; and
- Improving the Budget balance, by increasing taxes on wages and reducing income support payments;
- Reducing the labour force effects of an ageing population.

The Government's plan will definitely affect the incentives for people to enter work and remain in work:

- The reduction in marginal tax rates will encourage people to work more; but
- The increase in income may, at the margin, encourage people approaching the end of their working lives to work less, because their post-tax income can remain the same with a lower pre-tax income level.

It is not clear which of these two forces is larger. The Government has not released any modelling of the effect of the plan on participation. At Senate Estimates, the Secretary of the Treasury, Dr Ken Henry, suggested that it is "probably right" that individuals with lower wealth are more likely to extend working and those with higher wealth are less likely to extend working[9].

Therefore, ACCI encourages the Government to undertake detailed examination of the effects of the plan on labour participation.

Note that even without the plan, there would be an increase in participation by older people as the superannuation preservation age is being increased to 60.

7. POTENTIAL CONCERNS OF THE GOVERNMENT'S PLAN

The Government's plan has a few potential problems that need to be taken into account.

7.1. Cost

The cost of the Government's plan is $6.2 billion over the next four years (to 2009-10). However, of much more importance is the long term cost of the plan. There has been very little definitive information on this issue, which is discussed in Section 5 above.

One option for reducing the long term cost of the plan is to require more wealthy retirees to fund more health and ageing costs which are currently met by the Government. Some proposals for reducing retirees' dependence on the Government are contained in a discussion paper *Commonwealth Spending (and Taxes) Can Be Cut – And Should Be*, prepared for ACCI by Des Moore[10].

7.2. Lump sums vs Private Pensions

The current superannuation system provides some encouragement for retirees to take private pensions (income streams) rather than lump sums. The abolition of benefits tax means this preferential treatment of pensions is removed.

As a result, retirees could spend part or all of a lump sum and thus become eligible for more of the Government pension and larger health subsidies (ie double dipping). This runs against one of the main goals of the super system which is to reduce the cost of the Government pension. One solution to this issue is to require some portion of super benefits to be taken as a private pension or to provide some financial incentive to take a private pension.

- In response to this concern, the Government argues that the private pension incentive under the current system only affects a small number of retirees – in other words, the incentive for taking a private pension is negligible for most retirees. In addition, retirees obtain a better tax treatment by retaining money in super – if they withdraw money then it is taxed at marginal rates.

A long term costing of the Government's plan should determine the extent to which this is a problem.

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9. Hansard of Senate Economics Committee, Estimates, 1 June 2006, page 79.
10. Available from ACCI's website: www.acci.asn.au

7.3. Tax avoidance

It is not clear whether the Government's plan will encourage tax avoidance. One possible scheme is for people over 60 to invest money on behalf of their children. The tax previously paid by the children would be lost. It is not clear the extent of this problem, and whether it should be a concern of the Government and policy makers in the design of the plan. A good long term costing of the Government's plan should examine this issue thoroughly.

8. OTHER COMMENTS ON THE PLAN

8.1. Pension asset test

ACCI supports the reduction in the pension asset test. This will encourage saving (or at least reduce the incentive to dissave) for retirees. It will also reduce the effective penalty applying to assets with low returns.

8.2. Contributions by self-employed

ACCI strongly supports the proposal to allow for full deductibility for contributions made by the self employed. With an increasing number of people being self employed (such as independent contractors), this reform is vital to ensure that these people are treated equally with employees. It is also sensible for the self-employed to be able to access the same co-contribution scheme that is available to employees.

Concerns have been raised that there will be some people who are not able to meet either the employee or self-employed tests. ACCI therefore recommends that the Parliament should consider the recommendation of the Independent Contractors of Australia that the test for access to deductible contributions should be amended to allow access when taxpayers are earning 10 per cent or more of their income from carrying on a business, eligible employment or a combination of both. This is the same test as for the co-contribution scheme.

There is also an argument to allow employees to make deductible contributions. The Institute of Actuaries argues that this would increase simplicity and equity. We note that this may have a revenue cost which will need to be taken into account.

8.3. Tax File Number quotation

ACCI notes that there has been some concern over the quotation of Tax File Numbers (TFNs). In particular, there are a large number of superannuation accounts that do not have TFNs attached. Under the Government's plan, contributions to super accounts that do not have a TFN will be taxed at the top marginal tax rate. Super funds argue that it will require some effort to obtain these TFNs.

ACCI trusts that these concerns can be addressed without imposing costs upon employers. In particular, we are very wary of proposals to require employers to quote TFNs to super funds.

9. CONCLUSION

The Government's planned changes to the superannuation system are a dramatic simplification that will address ACCI's main concern with the old system. However, ACCI is not providing unqualified support for the plan, as it is not clear what the long term cost of the plan will be. If the costs are large, it is possible that the plan will mean the deferral or cancellation of tax reforms that ACCI consider to be of highest priority.

10. ACCI MEMBERSHIP

ACT and Region Chamber of Commerce and Industry
Australian Business Ltd
Business SA
Chamber of Commerce and Industry Western Australia
Chamber of Commerce Northern Territory
Commerce Queensland
Employers' First ™
State Chamber of Commerce (New South Wales)
Tasmanian Chamber of Commerce and Industry
Victorian Employers' Chamber of Commerce and Industry
Agribusiness Employers' Federation
Air Conditioning and Mechanical Contractors' Association of Australia
Association of Consulting Engineers Australia
Australian Beverages Council
Australian Consumer and Specialty Products Association
Australian Entertainment Industry Association
Australian Hotels Association
Australian International Airlines Operations Group
Australian Made Campaign Limited
Australian Mines and Metals Association
Australian Paint Manufacturers' Federation
Australian Retailers Association
Housing Industry Association
Insurance Council of Australia
Master Builders Australia
Master Plumbers and Mechanical Services Association Australia
National Electrical and Communications Association
National Retail Association Limited
NSW Farmers Industrial Association
Oil Industry Industrial Association
Pharmacy Guild of Australia
Plastics and Chemicals Industries Association
Printing Industries Association of Australia
Restaurant and Catering Australia
Standards Australia Limited
Victorian Automobile Chamber of Commerce