

Supplementary submission on retirement
incomes to

Australia's Future Tax System Review

September 2009 (21/09/09)



**Industry
Super
Network**

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About Industry Super Network

Industry Super Network (ISN) is an umbrella organisation for the industry super movement. ISN coordinates collective projects on behalf of a number of industry super funds with the objective of maximizing the retirement savings of five million industry super members.

Industry super stakeholders, the ACTU and AiG, were consulted in the preparation of this submission.

Comments to David Whiteley at dwhiteley@industrysuper.com.

Summary

The Henry review presents a once in a generation opportunity to reform Australia's tax and transfer system to meet the challenges of the future. With an aging population it is essential Australia has an equitable and efficient retirement income system that allows individuals to enjoy a decent standard of living in retirement. Australia's tax and transfer system is integrally linked to our superannuation system by influencing incentives to save and determining final retirement income outcomes.

Since the introduction of the Superannuation Guarantee (SG) there have been numerous ad-hoc changes to Australia's tax and transfer system that have altered incentives to save in superannuation and increased the complexity of the system.

It is essential that there is a certain and stable environment for individuals to save through superannuation. The Henry review presents a golden opportunity to reform the structure of incentives around superannuation to make them more transparent, equitable and efficient. A durable structure of incentives should limit the need for future changes to the system and give individuals the confidence to save for their retirement without worrying about the goal posts shifting.

1. Documents released by the review since May 2008 suggest the form and level of taxation on savings is being closely considered by the panel. It is critical that if a fundamentally new structure for taxation of savings is recommended, recognition is maintained for the unique role of super in preserving capital to fund retirement incomes, and driving growth in the capital base, productivity and financial stability.

Recommendation 1: That effective tax rates on superannuation retain a clear preference over non-superannuation savings.

2. While adequacy is difficult to define across the population the development of a minimum adequate benchmark would be a helpful yardstick for individuals to assess their retirement income goals and provide a better rationale for the targeting of concessions.

Recommendation 2a: The panel further consider an adequacy benchmark given existing gaps in the retirement income system and the need to appropriately target concessions.

There are a number of policy levers available to Government to address adequacy issues. The level of mandatory contributions, concessions on both mandatory and voluntary contributions, and the regulatory framework around default funds and fees and commissions are all mechanisms which can help achieve better retirement income outcomes. Arguably the best outcomes could be achieved through improvements in each of these areas.

ISN has argued vigorously that strongly performing default funds and better regulation of fees and commissions would go a long way to improving retirement outcomes for individuals. Adequacy could also be substantially improved through a phased increase in mandatory savings to a total of 12 percent, and an extension of the SG to cover exempted workers.

A more transparent and equitable distribution of tax concessions would also help to achieve stronger outcomes for retirees. The complexity of the system, most particularly the structure of concessions is likely to harm voluntary savings through disengagement. The existing tax concessions are inequitable and inefficient.

Many low income earners (especially women) have a penalty tax on contributions compared to other savings. Current tax expenditures are not achieving optimal levels of offsets in pension expenditures, largely because of the concentration of concessions at the upper end of the income/asset distribution which is outside the taper range for the age pension.

A simpler, more transparent mechanism to deliver concessions for superannuation contributions should be considered.

This would be best achieved through only allowing contributions from after tax income and providing a matching Government co-contribution (or equivalent tax offset) on both mandatory and voluntary savings.

Such an approach would re-balance concessions and allow low and middle income earners achieve better retirement outcomes while also providing more transparent concessions for voluntary contributions. The rebalancing of concessions would also assist in reducing pressure on age pension outlays over time by increasing the private savings of those most likely to be in the pension taper zones.

The planned reduction in concessional caps for those 50 years and over, as discussed in the following section, would also need to be addressed in this restructured concessional treatment of contributions.

Recommendation 2b : The panel reform the delivery of superannuation contribution concessions and move to a single transparent mechanism that delivers a flat rate matching Government co-contribution or tax offset on individuals' after tax contributions.

3. The reductions in the caps on concessional contributions to superannuation announced in the 2010 budget are a form of targeting which act to reduce the cost tax expenditures, particularly on high income earners.

However, the plan to further reduce the cap for those 50 and over from \$50,000 to \$25,000 in 2012-13 will also impact inappropriately on those with moderate lifetime earnings seeking to boost retirement accumulations late in working life. A higher cap for those 50 and over – either within the current structure of concessional contributions, or in the alternative proposed above – should be maintained, as those retiring in 2012 will have received the full rate of SG for a maximum of 10 years.

Recommendation 3: That the planned reduction of the caps on concessional contributions for those aged 50 and over in 2012-13 be postponed until average balances at retirement support adequate retirement incomes.

4. Raising the preservation age for superannuation will disproportionately impact low income, manual workers. Noting pressures from increased life expectancy, initiatives in this area should encourage a smooth transition and higher labour participation for those who want it, without removing flexibility for those without suitable options to stay in the workforce. Noting the Government's opposition to alignment of the preservation and pension ages, ISN supports the maintenance of a gap for equity reasons and to allow a phased transition to retirement.

Recommendation 4: That the current plans for the preservation age on superannuation – rising from 55 to 60 between 2015 and 2025 – remain unchanged.

5. A mandatory longevity product has many drawbacks as the associated loss of liquidity and flexibility would be a fundamental alteration to the basis on which super balances have been accumulated. Mandatory longevity products would benefit those most likely to have a longer life expectancy at the expense of those with shorter life expectancies.

While the redistributive effects are not clear given the longer life expectancies of women a mandatory longevity product may significantly reduce the choices available to many lower income individuals who have accumulated only modest superannuation balances. For this reason ISN does not support compulsory longevity insurance as a feature of Australia's retirement income system.

However with life expectancy continuing to increase consideration should be given to measures to improve the market for longevity products for those who wish to manage the risk of a longer than anticipated life expectancy. There should be care to ensure there is not undue market concentration of the development of such products. Industry super has demonstrated it is able to deliver exceptional outcomes at low cost and would be a proactive participant in the further development of longevity products.

Recommendation 5: That participation in longevity products is not made mandatory but consideration is given to other measures to improve the range and pricing of longevity products for those who wish to take them up.

1 The preferred status of superannuation

Since its inception the superannuation system has attracted tax concessions not available to other asset classes to make it the preferred retirement savings vehicle for Australians.

Superannuation, along with owner occupied housing, has the lowest effective tax rates among key savings classes in Australia.¹ Although there are issues with the distribution of superannuation concessions (see section 2), taken as a whole the generosity of superannuation compared to other savings is justified on account of the mandatory nature of the Superannuation Guarantee (SG) and because of preservation requirements.

The concessions have underpinned a significant growth in superannuation assets, contributing depth and liquidity to Australia's financial and capital markets, and as savings are invested have added to the productive base of the economy.

As a long term savings vehicle with asset allocations weighted accordingly, the superannuation system has added stability to financial and capital markets during the current global economic downturn.

We note the panel's interest in the taxation of capital and savings more generally as a potential area for further reform.

Available international evidence suggests effective tax rates on capital have been falling over time and there is a movement, in some jurisdictions, away from a comprehensive income tax benchmark that taxes nominal returns without regard to the portion of returns which compensate for inflation.

Movement away from a 'Haig-Simons' comprehensive income benchmark towards an expenditure tax benchmark implies lighter taxation of non-superannuation savings by taking into account compensation for inflation and deferred consumption.²

If effective tax rates on non-superannuation savings choices are to be lower then it will be important that superannuation retains a clear preference to compensate individuals for the mandatory saving component and preservation requirements.

Indeed it would be detrimental to retirement incomes to seek to equalise effective tax rates across all savings choices as it would result in a flow of discretionary savings out of superannuation into non-preserved savings classes.

Recommendation 1: That effective tax rates on superannuation retain a clear preference over non-superannuation savings.

¹ *Taxing capital income-options for reform in Australia* — paper presented to the Australia Future Tax System Conference by Professor Peter Birch Sørensen, Department of Economics, University of Copenhagen

² (Note: Superannuation currently may be more preferential than an expenditure tax benchmark)

2 The adequacy, sustainability and equity of superannuation tax expenditures

2.1 Adequacy

In its interim retirement incomes report the panel considered there was no justification to raise the level of compulsory savings above 9 percent arguing it delivered adequate replacement rates taking into account preferences for pre and post retirement consumption.

Industry Super Network (ISN) would urge the panel to revisit adequacy issues because of clear gaps in the system and doubts over certain key modelling assumptions.

As acknowledged in the report there are weaknesses in retirement outcomes for those who will not benefit from a full working life of SG. For example the report makes clear that a worker on 1 X AWOTE aged 50 in 2009 could expect a replacement rate of only 57.5 percent in retirement from a combination of the age pension and SG³.

Even then the individual would face a decline in their living standards compared to community standards because of the adoption of a CPI rather than wage deflator in retirement.

The interim report suggests such an individual would likely experience a replacement rate around 10 percent lower again if a wage deflator was used.⁴ As a consequence, under current settings, such an individual would experience a halving in future disposable income on retirement.

While it would be open for such an individual to make voluntary contributions to superannuation to achieve a better outcome our recent empirical research indicates voluntary superannuation savings are highly skewed, with almost no voluntary contributions made before the age of 40 and a majority of individuals making no voluntary contributions even in the years immediately before retirement.⁵

Part of the explanation for the low level of voluntary superannuation savings is that the existing structure of concessions is not conducive to this.

Firstly the nature of the concessions is opaque and not readily understood by the vast majority of individuals.

Secondly, as noted by the panel, access to concessional contributions may not be available to employees if their employer does not offer salary sacrifice arrangements.

While ISN believes under the existing framework a higher level of mandatory contributions would be the simplest way to address adequacy (a phased increase to a total of 12 percent gross contributions) progress could be achieved through a more equitable and efficient distribution of superannuation tax concessions.

Better targeting of tax concessions could also lessen long run costs of the age pension by improving the accumulated savings of those most likely to be in the taper zone of the age pension.

³ Table F1, p 68, AFTS Retirement Incomes Report on Strategic Issues

⁴ Table F2, p 69, *ibid*

⁵ ISN will provide to the panel a final draft of this paper on the voluntary superannuation contributions of UniSuper members in the week starting 21 September 2009.

2.2 The structure and distribution of tax concessions

The existing structure and distribution of superannuation concessions is inequitable, inefficient and opaque.

The practical operation of concessions is complex and arguably contributes to myopia.

A more equitable distribution of concessions through a clear and transparent mechanism has the potential to improve retirement incomes by stimulating greater voluntary savings earlier during working life and yield greater long run savings from age pension outlays.

2.2.1 Existing arrangements

The existing structure of concessions is very complex. There are currently seven different methods concessions may accrue depending on an individual's circumstances and income (see Table 1 below).

Table 1. Existing contribution arrangements and concessions

Contribution arrangements	Contribution tax	Other tax	Available Concession
Employer (SG)	15%	NIL	Contribution tax / personal tax wedge
Employee (salary sacrifice)	15%	NIL	Contribution tax / personal tax wedge
Employee (post tax)	0%	MTR (0-46.5%)	Low income co-contribution
Self Employed	0%	MTR (0-46.5%)	Personal superannuation deduction
Self Employed	0%	MTR (0-46.5%)	Low income co-contribution
Spouse	0%	MTR (0-46.5%)	Spouse superannuation tax offset
Spouse	0%	MTR (0-46.5%)	Low income co-contribution

Individuals face complex choices about whether their contributions are made from pre-tax or post tax income to maximise their concessions. For some employees particular choices may not be available depending on their employer (for instance the availability of salary sacrifice).

Existing contribution tax concessions are highly contingent on individual circumstances, but the broad outcome is such that the concession increases in line with the tax wedge between the contribution tax rate of 15 percent and an individual's personal marginal tax rate.

As a consequence, the level of concession on an individual's SG component increases with income, although the outcome is not transparent or predictable due to the interaction of means tested tax offsets (such as the low income tax offset) with the marginal tax rate schedule (see Table 2).

Table 2. Superannuation tax concessions by income (assuming \$1,000 of SG or salary sacrifice savings)⁶

Income	Marginal tax rate	Contribution tax rate	Effective concession on contributions (%)	Marginal tax on \$1000	Cont. tax on \$1000	Concession \$
\$0	0%	15%	-15.0%	0	-150	-150
\$15,000	16.5%	15%	1.5%	-165	-150	15
\$30,000	20.5%	15%	5.5%	-205	-150	55
\$35,000	35.5%	15%	20.5%	-355	-150	205
\$63,750	31.5%	15%	16.5%	-315	-150	165
\$80,000	39.5%	15%	24.5%	-395	-150	245
\$180,000	46.5%	15%	31.5%	-465	-150	315

For low income earners the concession on SG and any pre-tax contributions is negative as the contribution tax rate may be greater than their marginal tax rate. This impact is affecting more individuals every year as the effective tax free threshold increases in line with the changes to the Low Income Tax Offset (LITO). Treasury has estimated there are currently 1.6 million tax payers who receive no benefit or a negative concession.

It should be noted that this will have a disproportionate impact on the retirement savings of women who comprise more than two-thirds of part time workers and are thus likely to be on lower total incomes.

In contrast, a disproportionate share of tax concessions accrues to higher income earners.

In the panel's consultation report on retirement incomes it was disclosed that 5 percent of individuals account for more than 37 percent of concessional contributions. This group is likely to be dominated by high income earners who have the discretionary income to save, coupled with the greatest wedge between their marginal tax rate and the contribution tax rate.

Analysis undertaken by Treasury's RIM group has highlighted just how skewed the tax concessions extended to superannuation are⁷. The analysis shows the average tax expenditure on superannuation contributions increases sharply with income. This in itself is not surprising as the level of average concession is driven by an individual's marginal tax rate and capacity to save. The regressive effect is even clearer when it is compared with the distribution of taxpayers.

⁶ Includes impact of Medicare Levy and Low Income Tax Offset (2009-10 year)

⁷ (David Tellis, Projecting the distributions of certain superannuation tax expenditures on contribution, 17th Australian Colloquium of Superannuation Researchers)

While the largest cohort of taxpayers earning between \$20,000 and \$40,000 per annum receive a concession of less than \$500 per annum, individuals on much higher incomes are the beneficiaries of tax concessions many multiples of this. For example an individual on the top tax bracket is the beneficiary of an average concession of approximately \$5,000 per annum, and those earning over \$300,000 per year receive an average concession approaching \$9,000 per annum (more than half the value of a full age pension).

Chart 1. Average superannuation tax expenditure by income, 2009-10

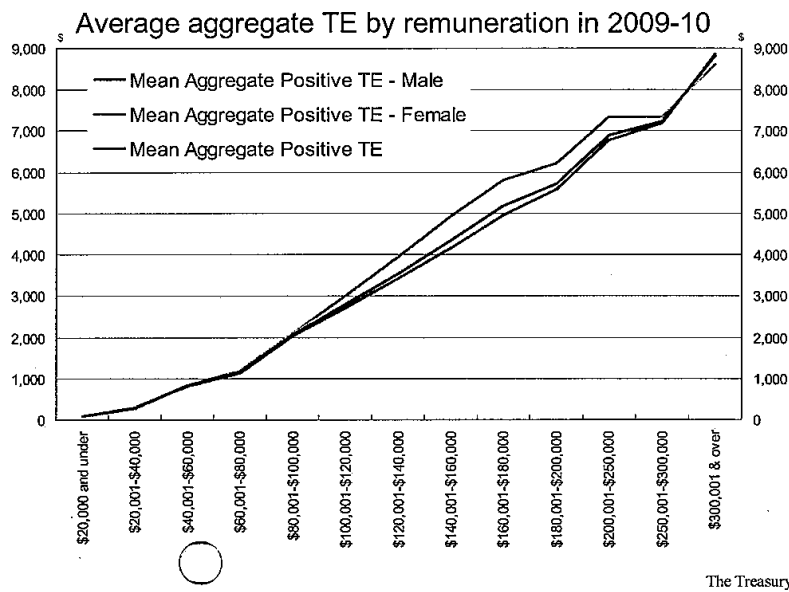
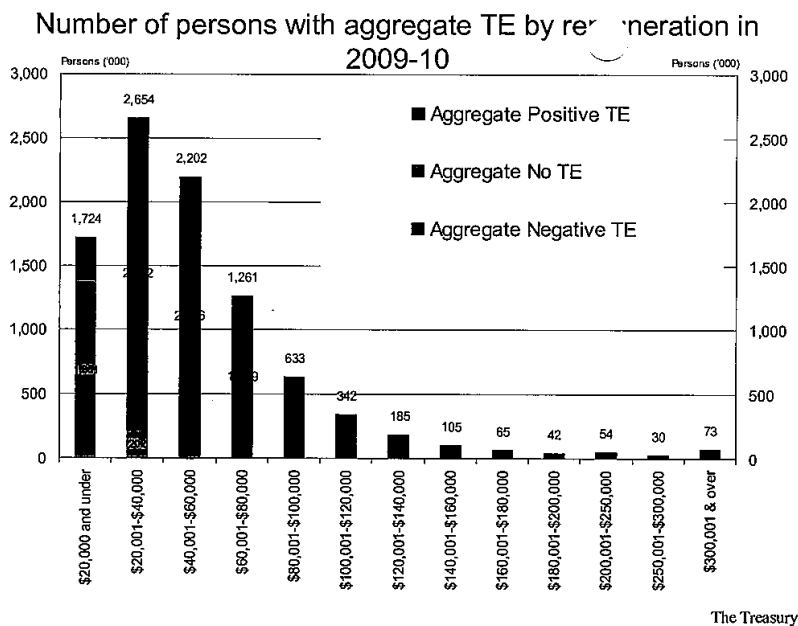


Chart 2. Persons by aggregate superannuation tax expenditure, 2009-10



It should be noted that this analysis incorporated the 2009-10 budget measure to halve the concessional contribution caps.

Even with these measures the panel should reassess the equity and efficiency of the current arrangements.

A large proportion of tax expenditures accrue to high income earners whose total saving may be affected only marginally, if at all, by the concession.

Arguably, a reduction in the level of concession to high income earners would not result in a switch in the allocation of discretionary savings because the tax concessions on earnings once in superannuation are more favourable than many other forms of savings.

The distribution of concessions may also explain why there are not greater offsets available in the age pension system over time.

To the extent that tax concessions accrue to individuals who will not be eligible for a part pension then no long run pension saving accrues.

Better targeting of concessions would reduce reliance on the public pension and reduce long run pension expenditures.

This approach need not require an increase in aggregate concessions, but merely better targeting of them.

An important feature of any future reform is to ensure the delivery of concessions is coherent and transparent. Coherent and transparent concessions could assist greatly with improving understanding and interaction with superannuation and stimulating earlier voluntary contributions.

Currently there are four discrete mechanisms for delivering concessions on contributions, namely; salary sacrifice, low income co-contribution scheme, deduction for personal superannuation contributions and the spouse contribution tax offset. Individuals face complex choices about which mechanism to use and some choices may not be available to them.

ISN believes a single coherent mechanism would be preferable.

2.3 Reform approaches

In considering a new platform for concessions the mechanism should be transparent and equitable. The current delivery of concessions through a wedge between an individual's marginal tax rate and contribution tax rate is not sustainable.

Apart from the fact that it is contingent upon employers offering salary sacrifice arrangements, as the effective tax free threshold increases more and more employees will have a negative concession on superannuation savings.

A different approach is therefore warranted.

A more coherent framework would involve the abolition of the superannuation contribution tax and for all SG and personal contributions to be made from post tax income.

The Government could then deliver concessions through a broad based flat co-contribution or tax offset paid direct to the superannuation funds.

The flat co-contribution or tax offset could be a fixed proportion of SG and voluntary contributions (up to a cap).

The concession would accrue at the same rate for all individuals regardless of their marginal tax rate (including a concession for those on a zero marginal tax rate).

To ensure most middle income earners are no worse off the concession would need to be at least 20.5 percent of gross contributions, however for simplicity a slightly higher level could be warranted (especially if the low income co-contribution scheme were replaced with the new arrangements).

Such a reform could be introduced in a broadly revenue neutral way through adjustment of concessional contribution caps.

Two possible design approaches are suggested:

- a flat 25 percent co-contribution or tax offset on SG and voluntary contributions, or;
- a flat 33 1/3 percent co-contribution or tax offset on SG and voluntary contributions - which would represent a gross 12 percent contribution with the 9 percent SG (i.e. 9%+3%)

Ideally all existing concessions would be rolled in so there is a single transparent mechanism equal to a fixed proportion of contributions.

A single transparent mechanism such as this would enhance awareness of the benefits of superannuation and voluntary savings. Workings of the 25% option are shown in table 3 below:

Table 3. Workings of a 25% matching Government Co-contribution or tax offset by income (assuming \$1,000 contribution)⁸

Income	Marginal tax rate	Contribution tax rate	Effective concession on contributions (%)	Marginal tax on \$1000	Tax after Co-cont on \$1000	Concession \$
\$0	0%	0%	25.0%	0	250	250
\$15,000	16.5%	0%	25.0%	-165	85	250
\$30,000	20.5%	0%	25.0%	-205	45	250
\$35,000	35.5%	0%	25.0%	-355	-105	250
\$63,750	31.5%	0%	25.0%	-315	-65	250
\$80,000	39.5%	0%	25.0%	-395	-145	250
\$180,000	46.5%	0%	25.0%	-465	-215	250

The new administrative arrangements should be designed to minimise, and preferably reduce, business and superannuation fund compliance costs. In the future, as real time data processing becomes available, the government co-contribution or tax offset could be paid at the same time as employee and employer contributions, but as an interim step

⁸ Includes impact of Medicare Levy and Low Income Tax Offset (2009-10 year)

it could be paid annually (as the existing low income co-contribution is) or quarterly, in line with the minimum frequency of employer superannuation contributions.

2.3.1 Impact on retirement outcomes

Modelling undertaken by ISN on these options suggests an improvement in retirement outcomes for low and middle income earners (albeit through a reduction in the generosity of concessions, especially through salary sacrifice, accruing to high income earners).

The greatest improvements occur at 0.75 x AWE and less (approximately half of all workers are at this income level and below).

At 1.0 x AWE there are marginal improvements with the 25% co-contribution option, without additional voluntary saving, as the level of this concession is only slightly above the 20.5% concession delivered by the status quo.

More significant improvements in retirement outcomes are available with the 33.3% co-contribution option as the level of concession is somewhat higher than the status quo.

The impact on replacement rates, accumulations and annual retirement incomes is shown in Table 4. In 2009 1.0 x AWE is approximately \$60,000 p.a.

Table 4. Proposed options compared to status quo (replacement rate, income and accumulation)⁹

Replacement Rate %	AWE Multiple					
	0.5	0.75	1.0	1.5	2.0	3.0
Current (9% SG only)	82%	67%	56%	43%	37%	39%
Current (12% with salary sacrifice)	91%	70%	59%	47%	49%	52%
25% co-contribution (on 9% SG only)	89%	68%	57%	43%	37%	36%
Matching 1:3 contribution (9%+3% gross)	91%	68%	58%	44%	41%	38%

Replacement Income p.a 2009\$	AWE Multiple					
	0.5	0.75	1.0	1.5	2.0	3.0
Current (9% SG only)	\$22,673	\$25,427	\$26,650	\$29,096	\$31,543	\$47,149
Current (12% with salary sacrifice)	\$25,019	\$26,650	\$28,281	\$31,543	\$41,910	\$62,866
25% co-contribution (on 9% SG)	\$24,476	\$25,621	\$26,979	\$29,140	\$31,618	\$43,544
Matching 1:3 contribution (9%+3% gross)	\$25,004	\$25,981	\$27,459	\$29,859	\$34,699	\$46,112

Accumulation 2009\$	AWE Multiple					
	0.5	0.75	1.0	1.5	2.0	3.0
Current (9% SG only)	\$138,760	\$208,141	\$277,521	\$416,281	\$555,042	\$832,563
Current (12% with salary sacrifice)	\$185,014	\$277,521	\$370,028	\$555,042	\$740,056	\$1,110,084
25% co-contribution (on 9% SG)	\$170,594	\$219,160	\$296,204	\$418,730	\$558,307	\$768,896
Matching 1:3 contribution (9%+3% gross)	\$184,198	\$239,566	\$323,412	\$459,542	\$612,723	\$814,243

⁹ Assumes use of wage deflator rather than CPI deflator.

It should be noted that the outcomes achieved under the two reform options occur without any voluntary contributions.

After factoring in 3 % voluntary contributions the two reform options deliver better outcomes than currently delivered through 3% additional salary sacrifice (12% total) for anyone on less than the top marginal rate of tax. For those on the highest incomes (over 3.0 x AWE) the proposed treatment is less generous than existing salary sacrifice concessions.

Table 5. Impact of proposed options including 3 % voluntary saving (replacement rate, income and accumulation)¹⁰

Replacement %	AWE Multiple					
	0.5	0.75	1.0	1.5	2.0	3.0
Current (9% SG only)	82%	67%	56%	43%	37%	39%
Current (12% SG or salary sacrifice)	91%	70%	59%	47%	49%	52%
25% co-contribution (with 3% additional voluntary contributions)	94%	71%	60%	47%	49%	48%
Matching 1:3 contribution (with 3% additional voluntary contributions)	95%	72%	62%	52%	54%	46%

Replacement 2009\$	AWE Multiple					
	0.5	0.75	1.0	1.5	2.0	3.0
Current (9% SG only)	\$22,673	\$25,427	\$26,650	\$29,096	\$31,543	\$47,149
Current (12% SG or salary sacrifice)	\$25,019	\$26,650	\$28,281	\$31,543	\$41,910	\$62,866
25% co-contribution (with 3% additional voluntary contributions)	\$25,767	\$26,909	\$28,773	\$31,618	\$42,157	\$58,058
Matching 1:3 contribution (with 3% additional voluntary contributions)	\$26,087	\$27,389	\$29,413	\$34,699	\$46,266	\$56,004

Accumulation 2009\$	AWE Multiple					
	0.5	0.75	1.0	1.5	2.0	3.0
Current (9% SG only)	\$138,760	\$208,141	\$277,521	\$416,281	\$555,042	\$832,563
Current (12% SG or salary sacrifice)	\$185,014	\$277,521	\$370,028	\$555,042	\$740,056	\$1,110,084
25% co-contribution (with 3% additional voluntary contributions)	\$227,458	\$292,213	\$397,961	\$558,307	\$744,409	\$1,025,195
Matching 1:3 contribution (with 3% additional voluntary contributions)	\$245,597	\$319,421	\$434,239	\$612,723	\$816,964	\$988,918

¹⁰ Assumes use of wage deflator rather than CPI deflator.

2.3.2 Relationship between concession level and caps

As noted under the proposed approach the co-contribution or tax offset would need to be capped to ensure either proposed mechanism is broadly revenue neutral.

With the fundamental re-targeting of concessions achieved through the proposed mechanism it would be appropriate to reconsider the application of the new annual concessional caps set in the 2009 Budget to allow greater flexibility for catch-up contributions.

While the most efficient targeting of concessions could be achieved on a lifetime basis using the accumulated balance, annual caps have been used in the modelled scenarios.

As currently modelled, the annual caps for the proposed co-contribution options are as follows:

- 25% option, maximum co-contribution of \$6,250.¹¹
- 33.3% option, maximum co-contribution of \$4000.¹²

In order to achieve the same budget impact under both options it would be necessary to more tightly target the more generous 33.3% co-contribution option by having a lower maximum co-contribution amount.

The relationship between the level of the concession, concessional caps and retirement outcomes depends on the policy objectives desired for the retirement income system.

The 25% option has been designed to deliver only a slightly greater concession to those on average earnings, whereas the 33.3% option is much more generous.

However the higher co-contribution would necessarily require tighter targeting which would diminish the flexibility of the concession regime to encourage voluntary saving.

If the policy objective is to achieve stronger retirement outcomes on a 9% SG only then the higher co-contribution rate may be most appropriate, however if the objective is to enhance individual engagement and achieve higher voluntary saving then the 25% option would strike the best balance by allowing a higher level of voluntary saving to attract the co-contribution.

A comparison of maximum contribution rates (inclusive of concessions) by income under the status quo and options may be found in the appendix (table 10).

The caps could be adjusted to achieve the desired revenue impact. It should be noted that aggregate concessions were reduced at the time of the budget and should as fiscal circumstances allow be reallocated as part of a reform package.

There should be a limit on the extension of concessions but a rigorous framework for equitable targeting of concessions requires a stronger view to be adopted on retirement income adequacy (through the prism of accumulations).

¹¹ Note: for anyone earning under 1.5 X AWE the proposed cap on the co-contribution is more generous than the effective concession available on the current \$25,000 contributions cap. On this option, to receive the maximum co-contribution, an individual would make \$25,000 of their own pre-tax contributions, to be matched 25% by the government ($\$25,000 * 25\% = \$6,250$).

¹² On this option, to receive the maximum co-contribution, an individual would make \$12,000 of their own pre-tax contributions, to be matched 1:3 (or 33 1/3%) by the government ($\$12,000 * 33 \frac{1}{3}\% = \$4,000$).

A fully formed view on adequacy is the only reasonable way to decide appropriate caps on concessions and send a signal to individuals about what an adequate retirement income goal is.

Recommendation 2a: The panel further consider an adequacy benchmark given existing gaps in the retirement income system and the need to appropriately target concessions.

Recommendation 2b: The panel reform the delivery of superannuation contribution concessions and move to a *single* transparent mechanism that delivers a flat rate matching Government co-contribution or tax offset on individuals' after tax contributions.

3 The impact of new concessional contribution caps on those nearing retirement

Among the policy changes made with respect to retirement incomes in the 2009/10 budget was a reduction in the level of concessional contribution caps from \$50,000 to \$25,000 indexed for under-50 years olds. The cap for those 50 and over has also been reduced, from \$100,000 to \$50,000 indexed until 2011-12, and to \$25,000 indexed from 2012-13 onwards.

We recognise the panel's concern that the benefits of the concessional tax treatment of superannuation disproportionately flow to those on high incomes and that this measure is one approach to apply targeting and limit the cost of tax expenditures. Indeed, the proposal discussed in the previous section provides an alternative approach to this issue.

However, we are confident that those who will be impacted by the reduction in these caps include many middle income earners nearing retirement who have received the top rate of SG for only the last few years of their working life.

The modelling of retirement incomes necessarily assumes a mature system. However, policy must also take into account the needs of the generation who have participated in the current system for a minority of their working life. The average balance of those nearing retirement currently is in the order of \$100,000, less than half the projected retirement accumulation of an average income earner in a mature system.¹³

It is undesirable for policy settings to prevent those approaching retirement with reasonable disposable incomes from boosting retirement accumulations through relatively high contribution rates in their remaining years in the workforce. Allowing relatively high levels of tax preferred contributions for older workers should also encourage higher work participation in this group.

¹³ Clare, R. 2007 (June), *Are retirement savings on track?*, ASFA (The Association of Superannuation Funds of Australia) Available online at www.superannuation.asn.au.

Recommendation 3: That the planned reduction of the caps on concessional contributions for those aged 50 and over from \$50,000 to \$25,000 in 2012-13 be postponed until average balances at retirement support adequate retirement incomes.

4 The superannuation preservation age

The retirement decision is complex, with influential factors including health and wealth of the individual and partner, current work prospects, and age thresholds built into the tax-transfer system.

It is a decision with far-reaching economic consequences for individual and community, and it is understandable that the review panel has considered signalling a higher retirement age by recommending the preservation age to be raised to match the new, higher, pension eligibility age.

However, we believe that individuals face very different options and pressures approaching the accepted 'retirement age', and that the as to when and how to retire should be left in the hands of the individual.

In particular, it should be recognised that raising the retirement age has an uneven socio-economic impact. Workers with lower pay and lower skills typically:

- have work that is more physically strenuous, and therefore more difficult in advanced age;
- have limited opportunities to work at reduced hours while utilising their skills;
- have lower life expectancies, and so will have a shorter retirement on average; and
- will often have entered the workforce earlier – likely closer to 15 than to 30 as is assumed in recent Treasury modelling.

Aligning the superannuation preservation and age pension age may also impact negatively on participation and pre-retirement incomes. The existing gap in preservation and age pension age allows transition to retirement involving part-time work which may be more appropriate for older age workers.

Noting the Government's opposition to alignment of the preservation and pension ages, ISN supports the maintenance of a gap for equity reasons and to allow a phased transition to retirement.

Recommendation 4: That the current plans for the preservation age on superannuation – rising from 55 to 60 between 2015 and 2025 – remain unchanged.

5 Longevity risk products

Longevity risk is currently borne almost exclusively by the state through the age pension, with adverse impacts on taxpayers and retirees and their families to the extent that the age pension is lower than a retiree's preferred retirement income. ISN notes the review panel's particular concerns around this issue and has contributed to the expert consultative group convened by the review secretariat.

Mandatory participation in a longevity product would represent a fundamental alteration of the terms on which retirement assets have been accumulated so far, and as such is not supported by ISN. Such an initiative would represent a radical reduction in the liquidity of superannuation assets, with a substantial loss of flexibility and freedom for retirees –

especially those with low accumulations. Depending on design it could also result in a reduction of voluntary contributions to superannuation.

While the re-distributive effects of a mandatory longevity product are not uniform, life expectancies are correlated with income, implying that a mandatory participation in longevity products would be regressive, redistributing from those with lower income and life expectancies to those with higher income and life expectancy.¹⁴

Voluntary longevity schemes, incentivised through preferred tax or means-test treatment, avoid the problems of reduced freedoms around retirement savings. However, voluntary longevity product markets exhibit adverse selection, with participants likely to be those with high individual life expectancies who expect to benefit from such products. The associated risk of higher than expected liabilities inevitably leads to poor pricing.

However with life expectancy continuing to increase consideration should be given to measures to improve the market for longevity products. There should be care to ensure there is not undue market concentration of the development of such products. Industry super has demonstrated it is able to deliver exceptional outcomes at low cost and would be a proactive participant in the further development of longevity products.

<p>Recommendation 5: That participation in longevity products is not made mandatory but consideration is given to other measures to improve the range and pricing of longevity products for those who wish to take them up.</p>
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¹⁴ Notwithstanding that the redistribution on gender lines is more positive, due to women's longer life expectancy on average, and women's lower incomes on average.

Appendix – Cameo tables

Table 6. Base Case (9% SG only)

	Multiple of AWE								
	33%	50%	67%	100%	133%	150%	200%	250%	300%
Income (gross)	20000	30000	40000	60000	80000	90000	120000	150000	180000
PAYG tax	-825	-2475	-5275	-12375	-18825	-22775	-34625	-46475	-58325
Income (net)	19175	27525	34725	47625	61175	67225	85375	103525	121675
SG contributions (gross)	1800	2700	3600	5400	7200	8100	10800	13500	16200
Voluntary contributions (gross)	0	0	0	0	0	0	0	0	0
Co-contribution (current)	0	0	0	0	0	0	0	0	0
Contribution tax	-270	-405	-540	-810	-1080	-1215	-1620	-2025	-2430
Contribution tax (PAYG Rates)	0	0	0	0	0	0	0	0	0
Co-contribution (proposed)	0	0	0	0	0	0	0	0	0
Contributions (net)	1530	2295	3060	4590	6120	6885	9180	11475	13770
Accumulation (35 yrs, AWE index)	92507	138760	185014	277521	370028	416281	555042	693802	832563
Annuity (22 yrs, AWE index, longevity)	5239	7858	10478	15716	20955	23575	31433	39291	47149
PAYG treatment	297	554	1278	1851	2844	3200	4266	5333	7533
Net tax-transfer on super contributions	270	405	540	810	1080	1215	1620	2025	2430
Marginal PAYG tax rate (incl LITO)	16.5%	20.5%	35.5%	35.5%	39.5%	39.5%	39.5%	39.5%	46.5%
Concessionalty \$	27	149	738	1041	1764	1985	2646	3308	5103
Concessionalty (% of income)	0%	0%	2%	2%	2%	2%	2%	2%	3%
Concessionalty (% of contributions)	1.50%	5.50%	20.50%	19.28%	24.50%	24.50%	24.50%	24.50%	31.50%

Retirement income (\$000s & %)

Super	5.2	7.9	10.5	15.7	21.0	23.6	31.4	39.3	47.1
Pension	14.8	14.8	14.5	10.9	7.3	5.5	0.1	0.0	0.0
Total	20.1	22.7	25.0	26.6	28.3	29.1	31.5	39.3	47.1
Super	27%	29%	30%	33%	34%	35%	37%	38%	39%
Pension	77%	54%	42%	23%	12%	8%	0%	0%	0%
Total	105%	82%	72%	56%	46%	43%	37%	38%	39%

Table 7. 12% contributions

	33%	50%	67%	100%	133%	150%	200%	250%	300%
Multiple of AWE									
Income (gross)	20000	30000	40000	60000	80000	90000	120000	150000	180000
PAYG tax	-825	-2475	-5275	-12375	-18825	-22775	-34625	-46475	-58325
Income (net)	19175	27525	34725	47625	61175	67225	85375	103525	121675
SG contributions (gross)	2400	3600	4800	7200	9600	10800	14400	18000	21600
Voluntary contributions (gross)	0	0	0	0	0	0	0	0	0
Co-contribution (current)	0	0	0	0	0	0	0	0	0
Contribution tax	-360	-540	-720	-1080	-1440	-1620	-2160	-2700	-3240
Contribution tax (PAYG Rates)	0	0	0	0	0	0	0	0	0
Co-contribution (proposed)	0	0	0	0	0	0	0	0	0
Contributions (net)	2040	3060	4080	6120	8160	9180	12240	15300	18360
Accumulation (35 yrs, AWE index)	123343	185014	246685	370028	493371	555042	740056	925070	1110084
Annuity (22 yrs, AWE index, longevity)	6985	10478	13970	20955	27940	31433	41910	52388	62866
PAYG treatment	396	738	1704	2418	3792	4266	5688	7110	10044
Net tax-transfer on super contributions	360	540	720	1080	1440	1620	2160	2700	3240
Marginal PAYG tax rate (incl LITO)	16.5%	20.5%	35.5%	35.5%	39.5%	39.5%	39.5%	39.5%	46.5%
Concessionalality \$	36	198	984	1338	2352	2646	3528	4410	6804
Concessionalality (% of income)	0%	1%	2%	2%	3%	3%	3%	3%	4%
Concessionalality (% of contributions)	1.5%	5.5%	20.5%	18.6%	24.5%	24.5%	24.5%	24.5%	31.5%
Retirement income									
Super	7.0	10.5	14.0	21.0	27.9	31.4	41.9	52.4	62.9
Pension	14.8	14.5	12.1	7.3	2.5	0.1	0.0	0.0	0.0
Total	21.8	25.0	26.1	28.3	30.5	31.5	41.9	52.4	62.9
Super	36%	38%	40%	44%	46%	47%	49%	51%	52%
Pension	77%	53%	35%	15%	4%	0%	0%	0%	0%
Total	114%	91%	75%	59%	50%	47%	49%	51%	52%

Table 8. 25% co-contribution on SG

	33%	50%	67%	100%	133%	150%	200%	250%	300%
Multiple of AWE									
Income (gross)	20000	30000	40000	60000	80000	90000	120000	150000	180000
PAYG tax	-825	-2475	-5275	-12375	-18825	-22775	-34625	-46475	-58325
Income (net)	19175	27525	34725	47625	61175	67225	85375	103525	121675
SG contributions (gross)	1800	2700	3600	5400	7200	8100	10800	13500	16200
Voluntary contributions (gross)	0	0	0	0	0	0	0	0	0
Co-contribution (current)	0	0	0	0	0	0	0	0	0
Contribution tax	0	0	0	0	0	0	0	0	0
Contribution tax (PAYG Rates)	-297	-553.5	-1278	-1851	-2844	-3199.5	-4266	-5332.5	-7533
Co-contribution (proposed)	450	675	900	1350	1800	2025	2700	3375	4050
Contributions (net)	1953	2821.5	3222	4899	6156	6925.5	9234	11542.5	12717
Accumulation (35 yrs, AWE index)	118082	170594	194809	296204	372205	418730	558307	697884	768896
Annuity (22 yrs, AWE index, longevity)	6687	9661	11032	16774	21078	23713	31618	39522	43544
PAYG treatment	297	554	1278	1851	2844	3200	4266	5333	7533
Net tax-transfer on super contributions	-153	-122	378	501	1044	1175	1566	1958	3483
Marginal PAYG tax rate (incl LITO)	16.5%	20.5%	35.5%	35.5%	39.5%	39.5%	39.5%	39.5%	46.5%
Concessionalty \$	450	675	900	1350	1800	2025	2700	3375	4050
Concessionalty (% of income)	2%	2%	2%	2%	2%	2%	2%	2%	2%
Concessionalty (% of contributions)	25%	25%	25%	25%	25%	25%	25%	25%	25%
Retirement income									
Super	6.7	9.7	11.0	16.8	21.1	23.7	31.6	39.5	43.5
Pension	14.8	14.8	14.2	10.2	7.2	5.4	0.0	0.0	0.0
Total	21.5	24.5	25.2	27.0	28.3	29.1	31.6	39.5	43.5
Super	35%	35%	32%	35%	34%	35%	37%	38%	36%
Pension	77%	54%	41%	21%	12%	8%	0%	0%	0%
Total	112%	89%	73%	57%	46%	43%	37%	38%	36%

Table 9. 33.3% co-contribution on SG

Multiple of AWE

	33%	50%	67%	100%	133%	150%	200%	250%	300%
Income (gross)	20000	30000	40000	60000	80000	90000	120000	150000	180000
PAYG tax	-825	-2475	-5275	-12375	-18825	-22775	-34625	-46475	-58325
Income (net)	19175	27525	34725	47625	61175	67225	85375	103525	121675
SG contributions (gross)	1800	2700	3600	5400	7200	8100	10800	13500	16200
Voluntary contributions (gross)	0	0	0	0	0	0	0	0	0
Co-contribution (current)	0	0	0	0	0	0	0	0	0
Contribution tax	0	0	0	0	0	0	0	0	0
Contribution tax (PAYG Rates)	-297	-554	-1278	-1851	-2844	-3200	-4266	-5333	-7533
Co-contribution (proposed)	600	900	1200	1800	2400	2700	3600	4500	4800
Contributions (net)	2103	3046.5	3522	5349	6756	7600.5	10134	12667.5	13467

Accumulation (35 yrs, AWE index)

127152	184198	212947	323412	408482	459542	612723	765903	814243
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Annuity (22 yrs, AWE index, longevity)

7201	10431	12060	18315	23133	26025	34699	43374	46112
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PAYG treatment

297	554	1278	1851	2844	3200	4266	5333	7533
-303	-347	78	51	444	500	666	833	2733
16.5%	20.5%	35.5%	35.5%	39.5%	39.5%	39.5%	39.5%	46.5%
600	900	1200	1800	2400	2700	3600	4500	4800
3%	3%	3%	3%	3%	3%	3%	3%	3%
33.3%	33.3%	33.3%	33.3%	33.3%	33.3%	33.3%	33.3%	29.6%

Retirement income

Super	7.2	10.4	12.1	18.3	23.1	26.0	34.7	43.4	46.1
Pension	14.8	14.6	13.5	9.1	5.8	3.8	0.0	0.0	0.0
Total	22.0	25.0	25.5	27.5	29.0	29.9	34.7	43.4	46.1
Super	38%	38%	35%	38%	38%	39%	41%	42%	38%
Pension	77%	53%	39%	19%	10%	6%	0%	0%	0%
Total	115%	91%	73%	58%	47%	44%	41%	42%	38%

Table 10. Effective contribution rates by income permitted by respective caps

Effective contribution rate permitted within annual cap (inclusive of concession)			
Income	Current (25k concessional cap)	Proposed 25%	Proposed 33.3%
\$10,000	250.0%	313%	160%
\$20,000	125.0%	156%	80%
\$30,000	83.3%	104%	53%
\$40,000	62.5%	78%	40%
\$50,000	50.0%	63%	32%
\$60,000	41.7%	52%	27%
\$70,000	35.7%	45%	23%
\$80,000	31.3%	39%	20%
\$90,000	27.8%	35%	18%
\$100,000	25.0%	31%	16%
\$110,000	22.7%	28%	15%
\$120,000	20.8%	26%	13%
\$130,000	19.2%	24%	12%
\$140,000	17.9%	22%	11%
\$150,000	16.7%	21%	11%
\$160,000	15.6%	20%	10%
\$170,000	14.7%	18%	9%
\$180,000	13.9%	17%	9%
\$190,000	13.2%	16%	8%
\$200,000	12.5%	16%	8%
\$210,000	11.9%	15%	8%
\$220,000	11.4%	14%	7%
\$230,000	10.9%	14%	7%
\$240,000	10.4%	13%	7%
\$250,000	10.0%	13%	6%