Australian Council of Social Service

29/08/14

Mr. David Murray AO
Chair
Financial System Inquiry
GPO Box 89
Sydney NSW 2001

Dear Mr Murray,

Re: ACOSS submission to the Financial System Inquiry

Thank you for the opportunity to provide a submission to the Government's Financial System Inquiry. ACOSS has deep concerns about the inequalities and inefficiencies in the current superannuation system, which undermine our capacity to ensure adequate retirement incomes, worsen our fiscal outcomes and distort savings decisions. As our population ages, Governments will face a challenge in funding high quality, accessible health and aged care. It will become increasingly difficult for them to do so while less than 20% of individuals over 65 years pay income tax; and age-based pensions, supplements and associated concessions extend to people who arguably do not need them.

ACOSS welcomes your observations on superannuation tax concessions made in your interim report, in which you question whether current policy settings are meeting the objectives of the superannuation system, and note their inequitable distribution and capacity to erode revenue.

Our superannuation system is complex, with at least five different tax treatments of superannuation contributions, depending whether they come from employers, employees, self-employed people, or spouses. The system also creates perverse incentives for individuals on high incomes to avoid personal income tax by diverting income into superannuation, without increasing their overall level of saving. A good example of this are tax minimisation schemes whereby wage earners over 55 years of age sacrifice salary into superannuation while at the same time drawing an equivalent after-tax amount in superannuation benefits. This and other tax avoidance opportunities would be curbed if the tax treatment of contributions was reformed to improve its fairness.

ACOSS supports the three pillar approach to retirement incomes, including The Age Pension, compulsory employer superannuation contributions and tax breaks for superannuation, but considers that superannuation tax concessions are poorly targeted and inefficient.

Since we lack a national social insurance scheme, Australia relies more on tax concessions for private superannuation saving than any other OECD country.[1] The cost of tax breaks for superannuation is

[1] The OECD estimates that these tax concessions cost 3% of GDP in 2007, well above the next highest 'spender' on retirement income tax concessions, Canada at 2.2%. OECD Social expenditure data base.

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roughly equal to that of the age pension: $32 billion in 2014-15, about the same as the annual cost of the Age Pension.

ACOSS considers that tax concessions for both compulsory and voluntary saving through superannuation are justified to the extent that they compensate individuals for forced saving through compulsory superannuation and encourage voluntary saving to achieve an adequate income in retirement and reduce reliance on the age pension. However, this means that they should ideally be targeted towards low and middle income earners since they are less likely to save for retirement, and more likely to rely on the age pension, in the absence of compulsion or tax incentives. This has long been recognised including by the OECD and the AFTS Review Panel.[2]

By contrast, currently the superannuation system is one of the most favoured tax minimisation vehicles for high net worth individuals, whilst if fails to deliver decent savings for the great majority. Since superannuation contributions are essentially taxed at a flat rate, those on high incomes receive a concession of around twice as much as those on average incomes per dollar invested. Decent reform of superannuation tax concessions is long overdue.

We consider that in the short term the government could extend the 15% tax on contributions to accounts in the pension phase (phased in at 5% pa from 1 July 2015), and impose a $25,000 annual cap on concessionally taxed superannuation contributions. In addition, measures to stem the churning of earnings though superannuation accounts should be implemented including reducing the annual cap for concessional contributions for every dollar withdrawn by a from a superannuation account in the same year. In the longer term, the unfair and complex system of tax concessions for superannuation should be restructured, so that all contributions are taxed at the individual’s marginal tax rate, minus a rebate.

I note you raised concerns that consumers are not engaged with the superannuation system, and that frequent reform of the system erodes confidence in it. ACOSS considers that a comprehensive review of the retirement income system is needed, and that engagement of the broader community in the reform process would assist with improving engagement and trust in the resulting superannuation system.

I have enclosed for your consideration in this review our 2014-15 budget priority statement, in which we provide recommendations that could be implemented immediately to improve the equity and efficiency of the superannuation system, and our superannuation policy statement ‘Building Super on a fair foundation: Reform of the taxation of superannuation contributions” which provides a more detailed discussion of necessary reforms to superannuation.

I would appreciate the opportunity to meet with you on these matters and I have asked my staff to liaise with your office to set up a meeting.

Yours faithfully,

[2] Antonin et al 2004, Long term budgetary implications of tax favoured retirement plans, OECD Economics Department Working Paper No16, AFTS Panel (2009) Report to the Treasurer.

Dr Cassandra Goldie
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