

Recommendations

The Recommendations in this Submission address the changes to superannuation legislation proposed in the Treasury Laws Amendment (**Fair and Sustainable Superannuation**) Bill 2016 (**Tranche II Taxation Bill**); Superannuation (Excess Transfer Balance Tax) Imposition Bill 2016 (**Excess Transfer Balance Tax Bill**); and the Treasury Laws Amendment (Fair and Sustainable Superannuation) Regulation 2016 (**Fair and Sustainable Superannuation Regulation**) (together, **Tranche II Legislation**). The detailed discussion is below.

1. Tranche II Taxation Bill

Recommendation a: propose taxing all fund earnings at 15 per cent instead of a \$1.6 million transfer balance cap proposed in Part 1 of Schedule 1. Short of this proposal, serious consideration should be given to a simple earnings threshold for taxing superannuation balances in the pension phase.

Recommendation b: support Part 1 of Schedule 2 which places a \$25,000 cap on annual concessional contributions, but note that a further reduction in the cap could be considered in the future.

Recommendation c: support Part 2 of Schedule 2 which lowers the threshold for the imposition of tax under Division 293 of the Income Tax Assessment Act 1997, but suggest that full taxation at marginal rates (TEE) could be considered in the future.

Recommendation d: support Part 1 of Schedule 6, but note that the carry-forward provisions are quite generous and could be limited to achieve better targeting of the concession.

Recommendation e: support Part 1 of Schedule 8, extending the earnings tax exemption to new lifetime products.

Recommendation f: support Part 1 of Schedule 8, removing the earnings tax exemption in respect of TRISs, but note that it could be modified to remove the tax disincentive to working for people taking a TRIS.

Recommendation g: support Part 1 of Schedule 9, removing the income tax deduction which is available because of the death of a member, for the benefit of their spouse. However it would be preferable for this measure not to be deferred until 1 July 2018.

2. Excess Transfer Balance Cap Bill

Recommendation: support the tax measures contained in the Excess Transfer Balance Cap Bill.

3. Fair and Sustainable Superannuation Regulation

Recommendation: support the tax measures contained in the Fair and Sustainable Superannuation Regulation Bill.

SUBMISSION

Introduction

This Submission is in respect of the proposed changes to superannuation law under the Treasury Laws Amendment (Fair and Sustainable Superannuation) Bill 2016 (**Tranche II Taxation Bill**); Superannuation (Excess Transfer Balance Tax) Imposition Bill 2016 (**Excess Transfer Balance Tax Bill**); and the Treasury Laws Amendment (Fair and Sustainable Superannuation) Regulation 2016 (**Fair and Sustainable Superannuation Regulation**) (together, **Tranche II Legislation**). This Submission comments on the main policy changes introduced by the Tranche II Legislation. It does not provide analysis of proposed administrative changes or legislative drafting.

It is often observed that Australia's superannuation system is difficult to navigate and complex. The changes introduced by the Tranche II Legislation and by the overall superannuation package introduce more complexity. It appears that simplicity as a goal of taxation has been sacrificed in the political compromise of the superannuation package.

Also sacrificed are measures which would support workforce participation. The first of these is the decision not to proceed with the repeal of the "work test" for people aged between 65 and 74. As outlined in our submission to Tranche I of the legislation, the work test means that the majority of people in the 65 to 74 age bracket are effectively unable to contribute to superannuation. The TRIS measures also create some issues. In the context of an ageing population there is clear imperative for measures to support workforce participation by people in older age groups. Some older people taking up work will not be able to make concessional contributions or will cease to be taxed in pension phase. This can create an effective "lump sum" tax on their workforce participation.

The second is the deferral of the spousal contributions concession from 1 July 2017 until 1 July 2018, an outcome which will disproportionately impact low income women as the primary beneficiaries of the new rules. Savings could have been achieved without compromising the superannuation savings of women in these groups. We outline some of these savings in this Submission.

Overall, the changes to taxation of superannuation introduced by Tranche I and Tranche II of the legislation are not substantial. They make the system fairer in some respects, but could have gone considerably further. Given the reform fatigue among the superannuation industry and individuals in the system, perhaps the greatest compromise to result from these changes is that they will prevent a consideration of system-wide reform to superannuation occurring at any time in the near future.

Finally, we note that a third and final tranche of legislation will cover the annual \$100,000 non-concessional contributions cap. We reiterate the comment made in

our submission to Tranche I of the legislation, that it would have been preferable to assess the measures as a complete package.

1. Tranche II Taxation Bill

a. \$1.6 million transfer balance cap

Part 1 of Schedule 1 of the Tranche II Taxation Bill imposes a \$1.6 million cap on the amount of capital that can be transferred to the tax free retirement phase of superannuation, from 1 July 2017. Sums in excess of \$1.6 million are commuted back to the accumulation phase and are taxed at 15 per cent.

A simpler option than the \$1.6 million cap would have been to tax all superannuation earnings at 15 per cent (consistent with current taxation in the accumulation phase), a position outlined in detail in Ingles and Stewart (2015).¹ The general approach proposed in Ingles and Stewart (2015) is for superannuation taxation to be based on a Tax (Contributions)-Exempt (Earnings)-Exempt (Payouts) (TEE) model of savings taxation. While it does not achieve that goal, taxing all earnings at 15 per cent would be a more coherent approach than the proposed reform. Instead, the \$1.6 million cap requires income stream providers to segregate a client's interests above and below the threshold, which creates complexity and potential equity issues when investments are successful or otherwise. We note that this complex piece of legislation runs to 89 pages, creating a bonanza for lawyers and accountants.

Taxing all fund earnings at 15 per cent, as we suggest, would involve heavier taxation in superannuation than outside it, for people with moderate cash balances. However in principle this is easy to address, either through a special rebate or a new class of superannuation funds in retirement phase, taxed akin to conventional managed funds. Either solution would be much simpler than the proposed new legislation.

We note that Schedule 1 of the Tranche II Taxation Bill imposes additional tax rules on recipients of defined benefit pensions in excess of \$100,000 to achieve a (supposedly) commensurate income. We have doubts that this level is commensurate, as the lump sum required to purchase an indexed annuity of this size is, at current prices, closer to \$3 million.

b. \$25,000 cap on annual concessional contributions

Part 1 of Schedule 2 of the Tranche II Taxation Bill introduces a \$25,000 annual concessional contributions cap, commencing 2017-18. Previously, the annual

¹David Ingles and Miranda Stewart (2015) *Superannuation Tax Concessions and the Age Pension: A Principled Approach to Savings Taxation* Working Paper No. 2015/7 (November 2015), <https://taxpolicy.crawford.anu.edu.au/publication/tpi-working-papers/7561/superannuation-tax-concessions-and-age-pension-principled> .

concessional caps were \$30,000 for those aged under 49 and \$35,000 for those aged 49 and above.

This Submission supports the \$25,000 annual concessional contributions cap, which brings the superannuation system closer to our recommended TEE model. A further reduction of the cap could be considered in future. We note that Part 1 of Schedule 2 also amends how concessional contributions are determined, so that contributions to constitutionally protected funds and unfunded defined benefit funds count towards an individual's concessional contributions cap. This Submission supports those changes.

c. 30 per cent contributions tax for contributions by those with incomes of \$250,000 and above

Part 2 of Schedule 2 of the Tranche II Taxation Bill lowers the threshold for the imposition of tax under Division 293 of the Income Tax Assessment Act 1997 (ITAA97), from \$300,000 to \$250,000. As a result of this change, contributions made by individuals who earn \$250,000 or more per year will be subject to tax at a 30 per cent rate. This Submission supports the lower threshold for Division 293 Tax and notes that a further reduction in the threshold could be considered in the future.

Taxing fund earnings during payout phase, as advocated in section (a) above, might seem inconsistent with our recommended overarching goal of TEE taxation of superannuation. However because current lump sums have been accumulated on a very concessional basis, any move to TEE should continue to tax prior accumulations using segregated accounts. Only new monies would be taxed under the TEE approach.

The concessional nature of the current system is illustrated by the estimated tax expenditure on superannuation on a TEE basis, of about \$12 billion per annum. The proposed new laws will trim this by only \$2 billion per annum. A TEE approach puts superannuation on the same tax basis as owner-occupied housing, so there is still no tax on the capital return – this would remain a concessional savings tax regime.

It is suggested that the Government could achieve a further \$10 billion of potential savings from further sensible reform of superannuation taxation and potentially an additional \$6 billion from the transitional taxation (at 15 per cent) of prior super accumulations. We would recommend that some of these monies be directed towards easing the newly legislated pension asset test, which can have a harsh impact on those with moderate amounts of saving and will incentivise some retirees to run down their savings very quickly. As explained in Ingles and Stewart (2015), the policy we support is a single deeming rate of 6 per cent in place of the implicit deeming rate of 15.6% under the new test.

d. Catch-up concessional contributions

Part 1 of Schedule 6 of the Tranche II Taxation Bill permits catch-up concessional contributions, where an individual has not reached their concessional cap in a previous year. Unused concessional caps from the last five financial years can be carried forward, up to a total superannuation balance of \$500,000. The measure applies to unused contributions from 2018-19 onwards.

While some flexibility might be attractive, this Submission queries whether the carry-forward provisions need to be so generous; they could, for example, be limited to fewer years and/or be subject to a lower annual concessional cap. Individuals who make voluntary superannuation contributions are a small proportion of high income earners who tend to have large superannuation balances and are mainly men. Permitting an annual concessional contribution of \$25,000 and then allowing five years in which to carry-forward any unused amounts provides an excessively generous tax concession that will disproportionately benefit people in this group.

e. Earnings tax exemption for new lifetime products

Part 1 of Schedule 8 of the Tranche II Taxation Bill extends the earnings tax exemption to new lifetime products such as deferred products and group self-annuities. While we have questioned the earnings tax exemption, we agree that if one is in place it needs to be extended to lifetime products for consistency, as so as not to discourage the development of such products.

f. Removal of tax exemption for earnings supporting a Transition to Retirement Income Stream (TRIS)

Part 1 of Schedule 8 of the Tranche II Taxation Bill also removes the tax exemption for earnings supporting a TRIS. To achieve this, the earnings tax exemption will be applied when a superannuation income stream is in the “retirement phase”, but this specifically excludes a TRIS.

A problem with this measure is that it draws a line between working and not working, when the reality is that some retirees drawing a pension move in and out of the workforce. On his or her returning to work, the superannuation fund moves to taxed (15 per cent) mode and this acts as a sort of “lump sum” tax over and above normal income tax.

It is not clear to what extent the TRIS measure will address the issues of people being able simultaneously to contribute concessional while also not paying earnings tax in their pension account. An alternative which circumvents these issues is to have an “on/off” switch: if a person is contributing to a super fund, the fund is put in accumulation mode (taxable), and can only switch to pension mode (tax free) if contributions cease.

g. Abolition of the anti-detriment provision

The Explanatory Material to the Tranche II Taxation Bill notes that the anti-detriment provisions are proposed amendments only.

Part 1 of Schedule 9 to the Tranche II Taxation Bill removes the income tax deduction which is available because of the death of a member, for the benefit of their spouse. This Submission agrees with the comments in the Explanatory Material that the provisions were intended to be transitional in nature and supports the removal of the anti-detriment provisions.

The Tranche II Taxation Bill also provides relief from capital gains tax (CGT) for gains which are realised purely to comply with the new legislation. The relief applies to Part 3 of Schedule 1 (the \$1.6 million transfer balance cap) and Part 1 of Schedule 8 (the changes to TRISs). This Submission supports CGT relief for these limited purposes, but again notes the complexity which is being introduced into superannuation law as a result of the new transfer balance cap. Short of the taxation regime which we advocate, serious consideration should be given to a simple earnings threshold for taxing super balances in pension phase. We note that this is ALP policy (they suggest a threshold of \$75,000). This comment also applies to our discussion in section 2 below.

2. Excess Transfer Balance Cap Bill

The Excess Transfer Balance Cap Bill introduces penalty tax under the ITAA97, for superannuation balances which exceed \$1.6 million (the cap is \$100,000 for defined benefit income streams). Tax of 15 per cent on annualised notional earnings is payable where a person has not been previously liable for excess transfer balance tax, and 30 per cent where they have been previously liable. This Submission supports the tax measures contained in this Bill.

3. Fair and Sustainable Superannuation Regulation

This Regulation makes a number of consequential amendments to the Income Tax Assessment Regulations 1997 so that they align with measures contained in Tranche I and Tranche II of the superannuation package. Our comments in respect of the TRIS measures in the legislation, outlined above in 1(f), also apply to the consequential amendments to regulation 995-1.03.