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cc Secretary – letter only

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5 November 2008

Dr Ken Henry AC
Secretary
The Department of the Treasury
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Dear Dr Henry

AMP welcomes the opportunity to make a submission to the Australian Government's Review of the Tax System and a copy of our submission is attached.

The submission focusses on the Review's terms of reference relating to national savings rather than more detailed technical concerns. As such, it is strategic in nature and makes a range of policy proposals designed to enhance superannuation adequacy.

In addition to these proposals, AMP has provided input to IFSA, ASFA and the FPA in relation to the more technical issues.

Should you have any queries in relation to the submission please contact me on 0412 437 315.

Yours sincerely

Alastair Kinloch

# AMP submission to the Review of the Australian Taxation System

October 2008

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## EXECUTIVE SUMMARY / RECOMMENDATIONS

The Australian superannuation / pensions system works extremely well and is the envy of the world. As a consequence, there is no need to fundamentally change the three-pillar approach, a model that has stood the test of time.

The task is now to build on this foundation to further enhance Australia's retirement income adequacy for all Australians. AMP considers that the system could be improved if the following recommendations were adopted:

- That an official target such as 65 per cent of pre-retirement income at 65 be adopted. (para 4a)
- That the present concessional treatment of superannuation, including the tax-free treatment for those over 60 is maintained (para 4b)
- That the transition to retirement (TTR) arrangements, whereby individuals can access their superannuation from age 55 while still remaining employed, are maintained
- That the transitional arrangements from the *Simpler Super* package, which provide for higher levels of tax-deductible contributions for those over 50 years as at 1 July 2007, be retained and extended for all those over 50 (para 4c and 4e)
- That the Government should assist those who have inadequate retirement savings as a priority especially:
    - Women, who suffer lower incomes and broken patterns of employment compared to men (para 3a)
    - contractors / self-employed who are not covered by the compulsory SGC payments (para 3b)
    - low income earners (para 3c)
    - older people who have not benefited from the compulsory SGC system throughout most of their working life (para 3d)
- That a range of measures be used to improve the levels of superannuation adequacy of the above groups (para 4e) including:
    - an enhanced co-contribution strategy
    - increasing the contribution limit of $50,000 for older workers
- That at an appropriate time consideration should be given to increasing the SGC either in full or through soft compulsion to around12 percent (para 5a)

- That consideration should be given to adjusting the preservation age upwards to mirror the increase in life expectancy (para 5c)

## 1 Introduction

AMP welcomes the Government's decision to commission a comprehensive review into Australia's future tax system. Such a review is timely and provides an opportunity to redress some of the shortcomings of the existing superannuation system.

This submission is confined primarily to issues relating to superannuation adequacy concentrating on the following terms of reference:

- Improvements to the tax system, including for retirees (ToR 3.2)
- Enhancing the taxation of savings (ToR 3.3)
- Incentives for individuals to save and provide for their future (ToR 4.2)

AMP will make additional proposals in relation to the more technical taxation matters through the relevant industry associations including IFSA, ASFA and the FPA.

Many of the recommendations contained in this submission flow directly from research work commissioned by AMP and undertaken by Access Economics. The key finding of the Access Economics research is that even using relatively optimistic assumptions in relation to retirement incomes adequacy (AMP's measure includes pensions, superannuation and other savings), there remains a substantial shortfall in retirement savings. Access Economics estimates that around 30 percent of the population currently have inadequate savings for their retirement.

The conclusion is that although the Australian retirement income system is very good by international standards, there are still large sections of the community with inadequate retirement incomes. Policy change is needed to rectify this situation so that the overwhelming majority of Australians will have adequate retirement incomes.

AMP considers that appropriate changes to the taxation system would assist in addressing these inadequacies and improve the incentive for people to save and provide for their future. This, in turn, will provide higher levels of retirement incomes, helping to ameliorate some of the longer-term fiscal pressures on the Commonwealth Budget from the ageing of the Australian population.

## 2 History of the Australian Superannuation System

Up until the 1980s superannuation in Australia was voluntary. Coverage was largely confined to employees who worked in either the public sector or who worked for major employers who managed their own superannuation fund for their employees.

The majority of the workforce did not fall into either of these categories and consequently superannuation coverage was limited to about 40% of the workforce. Adequacy varied considerably, with public sector employees generally faring best.

Under the ongoing process of the Prices and Incomes Accord a superannuation component was negotiated between the Hawke Government and the trade union movement. This led to reasonably widespread superannuation arrangements being introduced under industrial awards negotiated between 1986 and 1988.

The Commonwealth supported this phased introduction of a compulsory superannuation contribution as part of a "wage-tax trade off", allowing a non-inflationary means of wage increases. Current income was literally transformed into deferred (ie retirement) income. The general rate was only 3%, but some awards contained higher amounts. The main aim was to dramatically spread the coverage of superannuation, which the initiative achieved.

Australia, along with many other Western nations, was facing a major demographic shift in the coming decades. This would have inevitably resulted in a large rise in the public cost of the age pension placing a significant and growing strain on the Commonwealth Budget.

The proposed solution was a "three pillars" approach to retirement income:

- A safety net consisting of a means-tested Government age pension system
- Private savings generated through compulsory contributions to superannuation
- Voluntary savings through superannuation and other investments

Building on the success of the original 3% arrangement, the compulsory 9% "Superannuation Guarantee Charge" (SGC) was introduced as part of a major reform package addressing Australia's retirement income policies. It also broadened coverage to those not dependent upon an industrial award or agreement.

Since its introduction, employers have been required to make compulsory contributions to superannuation on behalf of most of their employees. This contribution was originally set at 3% of employees' income, with a phase in arrangement to rise to 9% by 1 July 2002. Recognising the greater ability of larger business to bear the cost of the SGC their phase in was faster than that applying to small business.

Though there is general widespread support for compulsory superannuation today, it was met with strong resistance by small business groups at the time of its introduction who were fearful of the burden associated with its implementation and its ongoing costs.

The former government, rather than pursue a policy of an increase in the *compulsory* SGC, decided to introduce measures aimed at increasing *voluntary* superannuation contributions by individuals, known as the Government Co-contribution scheme (GCC).

The GCC provides a matching grant, currently set at a maximum rate of $1500, for eligible contributions to superannuation funds made by employees. A means test applies to determine what GCC is actually payable with the rate phasing to nil as an employees income rises.

The GCC provides an opportunity for the government to target groups in the community with inadequate savings for further support.

## 3 Retirement incomes Adequacy

Australians enjoy a world-class superannuation/retirement incomes system, which as indicated above involves both compulsory contributions from employers, voluntary contributions from both employers and employees and direct matching cash contributions from the Commonwealth (the Government Co-contribution).

Despite this excellent framework a significant minority of Australians currently have inadequate retirement savings, and are consequently predicted to leave the workforce with inadequate resources.

This shortfall will intensify the pressure on public resources, especially social security payments in future decades as the Australian population ages.

In order to determine the overall level of retirement incomes adequacy, AMP commissioned Access Economics to develop a retirement incomes adequacy index which is released twice a year. The Access Economics modelling uses data provided by AMP from 320,000 of its customers. The Superannuation Adequacy Index (SAI) is one of the most reliable estimates on retirement savings because it uniquely marries both detailed contribution data and account balances to provide the best overview of the current Australian situation.

The most recent issue of the AMP Superannuation Adequacy Index estimates around 30 per cent of the community have inadequate savings for retirement.

It is clear from the analysis that particular groups face problems.

a) Women

Females in particular are disadvantaged across all age and income groups. This disadvantage arises from a combination of lower average remuneration across most vocations, broken work patterns and higher participation in part-time or casual employment.

As Table 1 below demonstrates, on average, women have substantially lower account balances than men across all age groups. The relative disadvantage increases as age increases.

**TABLE 1: AVERAGE SUPER BALANCE – ACTIVE MEMBERS, DECEMBER QUARTER 2007**

| Age | Balance ($) | | |
|---|---|---|---|
| | **Males** | **Females** | **Average** |
| **20-24** | $5,917 | $4,487 | $5,277 |
| **25-29** | $14,294 | $12,598 | $13,573 |
| **30-34** | $27,867 | $23,941 | $26,352 |
| **35-39** | $42,701 | $32,010 | $38,850 |
| **40-44** | $60,455 | $35,557 | $51,319 |
| **45-49** | $77,271 | $39,989 | $63,314 |
| **50-54** | $98,722 | $48,491 | $79,534 |
| **55-59** | $110,391 | $60,555 | $91,638 |
| **60-64** | $99,705 | $65,318 | $88,684 |
| **65-69** | $93,465 | $55,536 | $83,767 |
| **Average** | **$51,639** | **$30,887** | **$44,013** |

b) Contractors/Self Employed

Due to various historical reasons and the design of the Superannuation Guarantee System the self-employed often have inadequate savings.

Part of this can be explained by the needs of the business, ie often the self-employed re-invest most of their earnings in their business for use as working capital. Often small business people have viewed their small business as their "superannuation" and have thus concentrated on trying to grow the business, rather than setting aside specific superannuation savings.

This trend has been historically reinforced by the design of the tax concessions that have applied to the self-employed.

For example, until recently employees enjoyed a more generous set of income tax deductions for an equivalent level of superannuation contributions made by an employer on their behalf than if the same level of contributions were made by a self-employed person on the same level of income as the employee. The rationale for this treatment was not clear, but it appears to be a legacy of history rather than a deliberate policy by any particular Government to discriminate against this group.

Secondly, the design of the Superannuation Guarantee Charge discriminates against the self-employed as they are not covered by it. The SGC imposes an obligation on employers to provide the nominated level of superannuation support to their employees. Failure to do so renders them liable to pay a default amount to the Government – the SGC.

While the compulsory nature of the SGC has massively increased the aggregate level of superannuation coverage for employees, an equivalent increase in superannuation coverage for the self-employed has not occurred.

### c) <u>Low Income Earners</u>

As well as having to live on modest means, low income earners are disadvantaged as they often have broken periods of employment or may face employer non-compliance with superannuation liabilities.

Those on very low incomes also face low marginal tax rates, which means that they may derive small or even no advantage due to the tax concessions which apply to superannuation. This situation undermines the attraction of voluntary contributions to this group.

Worse still, if an individual's income is under $450 per month, then employers are not required to pay an SG contribution.

### d) <u>Older Employees</u>

Much of the inadequacy of retirement incomes savings occurs in older age groups. This has arisen largely because many in this group have spent much of their career with either no or inadequate superannuation coverage. Historically, governments have recognised the need for those close to retirement to be able to "top up" their superannuation by granting tax concessions for contributions significantly above the general level.

As part of the "Simpler Super" package that commenced in July 2007, a general cap on tax deductible contributions of $50,000 per year was introduced for all employees.

Some special transitional provisions were introduced for those aged over 50 at the time. However, those provisions will expire in 2012. AMP is strongly of the view that some kind of "top up" arrangement should be available permanently as there will always be those who have inadequate retirement incomes in the decade before retirement and that they should be given every reasonable opportunity to achieve adequacy through additional voluntary contributions should they so desire.

## 4 Proposed Policy Options

AMP believes that a comprehensive policy response to improve the incentive to save is needed.

a) The need for a target

First and foremost, a goal or target needs to be established in relation to adequacy. The generally accepted target is "65 at 65". There are different suggestions of exactly how this should be defined. AMP in its SAI reports adopt the definition of 65% of pre-retirement disposable consumption, where consumption is defined as pre-retirement income, less tax and savings. In the SAI this includes pensions, superannuation and other savings as available income post retirement.

AMP considers this to be the optimal target, but AMP would support a different model should this be agreed to by the government. The most important point is to set an official long-term goal that will assist people to focus on the higher levels of self-provision needed to achieve retirement incomes adequacy.

b) Existing Concessional arrangements need to be retained

The general concessional nature of the tax treatment of superannuation contributions, earnings and end benefits has contributed to the widespread acceptance of the compulsory SGC system. It needs to be retained.

If the current level of tax concession were reduced, then many would question the benefit of the 9% forced retirement savings. In light of this, AMP considers that calls to reduce the current level of concession are misplaced and would be counterproductive. The national superannuation arrangements, as well as providing the direct economic benefit of a significant and growing financial services and funds management sector, has also contributed to the very strong macro-economic performance of the Australian economy over the past 15 years

Accordingly, AMP applauds the Government's decision to retain the tax-free superannuation benefits from taxed superannuation funds for those members who are over 60 years of age. As well as simplifying the superannuation taxation arrangements considerably, the provision of a tax-free income stream in retirement has significantly increased the incentive to save for retirement.

Whilst it is difficult to be certain about the precise long-term effects of the new "*Simpler Super*" regime, especially because of the turmoil associated with the financial impacts arising from the US sub-prime crisis, AMP's superannuation Adequacy Index analyses show that a consistent improvement in underlying rates of superannuation savings of around 0.4% of income has been achieved, in turn leading to increased adequacy.

Accordingly, it is reasonable to assume that further improving the return to retirees through lessening the tax burden, eg by reducing fund income or contributions tax would also further enhance contribution rates and hence aggregate adequacy.

c) <u>Transition to retirement</u>

There are three policies which collectively reinforce retirement income adequacy through incentives for longer attachment to the workforce, namely the tax free status of benefits for those over 60, the TTR provisions and the concessional level of tax deductible contributions for those over 50 at 1 July 2007.

The most important design feature of the "*Simpler Super*" changes was linking the tax-free retirement income stream to continuing in the workforce until aged 60.

Clearly, it is too early to make long-run judgements about the effectiveness of the policy in encouraging those contemplating retirement to remain in the workforce longer thereby improving their retirement incomes adequacy and ameliorating the skills shortage. However, there is anecdotal evidence to suggest that people are motivated by the taxation concessions to continue workforce participation for longer than they otherwise would, and that while further work needs to be done, this element of policy appears to have been successful.

Another important aspect of encouraging greater longer-term attachment to the workforce is the Transition to Retirement (TTR) measures introduced in 2004. These policies recognise that many people, rather than wanting to work full-time and then retire completely, would prefer to "transition" to retirement through part-time or lesser work effort in the latter part of their career.

The TTR specifically facilitates this "transition" by allowing retirees to access their superannuation at age 55 whilst still keeping a connection to the workforce. This policy encourages older Australians to continue working, increasing national productivity and often retaining key skills and experience at a workplace. It is an important complement to the tax free at age 60 policies and should be explicitly retained. It also assists considerably for those who wish to increase voluntary contributions.

TTR is also consistent with the proposal (see Older Working Australians section below) to expand the allowable contribution rates for older Australians to $100,000 to allow for late career top ups for those with inadequate superannuation.

d) <u>Contribution rates</u>

As well as having a 9% compulsory component, AMP's Superannuation Adequacy Index shows that Australians save around 4% of their income as voluntary superannuation contributions every year through either salary sacrifice or post tax contributions. In other words, the total level of contributions as at December 2007 was around 13% of income, rather than just the compulsory 9%, as is often assumed – see Table 2 below.

**TABLE 2: CONTRIBUTION RATES BY AGE, DECEMBER 2007**

| Age | Super Guarantee (SG)/Award | Salary sacrifice | After-tax | Total |
|---|---|---|---|---|
| 20-24 | 9.4% | 0.5% | 0.2% | 10.1% |
| 25-29 | 9.5% | 0.6% | 0.2% | 10.2% |
| 30-34 | 9.5% | 0.9% | 0.2% | 10.6% |
| 35-39 | 9.5% | 1.1% | 0.3% | 10.9% |
| 40-44 | 9.5% | 1.7% | 0.5% | 11.6% |
| 45-49 | 9.5% | 2.7% | 0.7% | 12.8% |
| 50-54 | 9.5% | 5.1% | 1.4% | 16.0% |
| 55-59 | 9.5% | 7.6% | 2.3% | 19.4% |
| 60-64 | 9.5% | 10.9% | 4.6% | 25.0% |
| 65-69 | 9.5% | 10.1% | 4.9% | 24.4% |
| **All workers** | **9.5%** | **0.8%** | **2.6%** | **13.0%** |

It is absolutely vital that this additional level of voluntary savings be maintained – and ideally increased to maintain and hopefully improve retirement incomes adequacy over time.

Contribution rates increased to 13% in the second half of 2007. However, somewhat disappointingly, unpublished SAI data shows that these have declined by around 1% to around 12% in the first half of 2008, primarily as a consequence of the financial crisis. It is not clear what will happen in the future although it is possible contribution rates will decline further in the near term.

e) <u>Targeted Government Co-contribution</u>

AMP considers that for some particularly disadvantaged groups more than just attractive taxation concessions will be required to help members successfully fund their retirement. A particularly useful tool to target particular groups is the GCC.

Currently the GCC is designed to address inadequacies based on income levels. However, AMP believes that there is merit in examining whether the current arrangements can be augmented to provide additional assistance, and therefore incentive for particular groups to increase their retirement savings effort.

<u>Women</u>

Policy options for women could include:

- additional government co-contributions to be available to women who have left the workforce for family reasons while on maternity leave, or alternatively:
- additional contributions once they re-enter the jobs market.

Self Employed/Contractors

Policy options for self employed/contractors could include:

- higher tax incentives for example increasing the annual contributions limit from $50,000.

Very low income earners

There is a particular problem with very low income earners as their marginal tax rates are low and accordingly there is little incentive for them to make additional contributions to superannuation which has a contributions tax of 15%.

Options could include:

- special rebates of the contributions tax based on a means test in order to make voluntary additional contributions more attractive; and/or

- a higher rate of GCC could be available for low income earners, eg Commonwealth paying 200% of eligible contributions

Older Working Australians

For older Australians

- the government could consider extending the transitional arrangements introduced for the Simpler Super System for a further three years; and/or

- introduce a more general higher contribution rate (eg $100,000) for those over 50

An alternative incomes based approach

An alternative approach could be developed with the government making a needs based contribution based on salary. Rather than, as at present, having a $57000 cap for the GCC, all workers making a post tax salary contribution to super could be eligible for a co-contribution, with the level of government support varying depending upon income.

For example, for low income earners who voluntarily contribute 1% of their salary to superannuation, the government could contribute a further 5%; for median income earners that contribute 3% of their salary to superannuation, the government could contribute a further 3%, and for high income earners that contribute a further 5%, the government could make a 1% additional contribution.

In this way all employees that take up this proposal would effectively be making a contribution to super of at least 15%.

The proposal would need to be costed, and phased in over time and has a number of advantages over a compulsory increase in the SGC.

## 5 Longer term initiatives

a) SGC

In the event that the targeted measures above are insufficient to raise adequacy to 100%, AMP considers that over the longer term the Government should set a target rate of superannuation contributions at a higher level than is currently the case.

The current total average contribution rate is around 13 per cent but could be increased to a target of around 15 or 16 per cent.

AMP believes that the increase could be achieved by increasing the SGC by 2 to 3 per cent. This would obviously have to be done in an economically responsible fashion after other options have been explored.

The implementation would have to complement other Government economic policies and would have to be phased in at an appropriate rate. Consideration could be given to implementing a large employer/small employer differential as applied when the SGC was originally introduced in 1992.

Under such an arrangement larger employers, who generally have a greater ability to absorb an increase in the level of the SGC, would be raised sooner with the phase in for small employers staggered over a longer timeframe.

Such a move would contribute to higher levels of savings, it should assist in increasing the available pool of capital for Australian firms to invest, it should assist in reducing the current account deficit over time, and it may have the effect of reducing interest rates thereby assisting business by lowering the costs of capital and assisting homeowners with their largest expense.

b) Soft Compulsion

An alternative model would be to adopt a "soft compulsion" approach to a further top-up of the SGC. That is, the further 2 or 3 per cent compulsory contribution mentioned above could be by way of an avoidable increase. Employees would have the option of rejecting an increase on the 9% compulsory SGC and taking the additional amount as salary instead.

Whilst this would introduce a new element of complexity into the current system, it is expected that most people would opt to take the amount as superannuation, thereby substantially addressing much of the current adequacy shortfall over time.

c) Preservation Age

The superannuation preservation arrangements have never been properly integrated into the age pension system. Retirement incomes adequacy would be enhanced if members preserve their benefits longer. This allows both greater accumulation of superannuation balances and lessens the period of retirement for which the savings need to finance.

At the same time, longevity is increasing - thereby increasing the period of retirement that most people enjoy.

Consideration should be given to adjusting the preservation age upwards to mirror the increase in life expectancy that will accrue over the next four decades.

As Australians are living longer, we need to ensure that more people maintain a longer connection to the workforce, both to ensure an adequate supply of labour into the future and to assist in the earning of adequate retirement incomes to allow retirees a high standard of living for all of their retirement years, not just for the first phase of retirement

The preservation age was increased from 55 to 60 in a politically bipartisan manner in order to begin to address the mismatch between expectations of higher standards of retirement incomes and the desirability of early retirement.

Equally, a responsible phased increase in the commencement age of women's aged pensions was achieved due to the long-term fiscal pressures of the ageing of the population and the reality of the relative longevity of women compared to men.

A long-term goal should therefore be adopted to both:

- increase the superannuation preservation age over time to align it with the age pension commencement age; and

- increase the age pension commencement age to take account of the increasing longevity in the community.