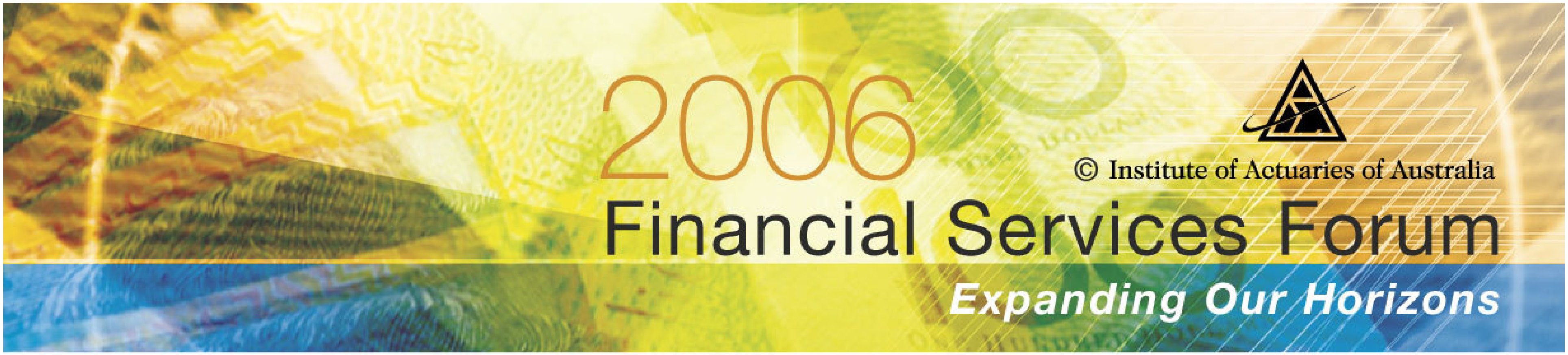

Superannuation Tax Reform 2006

Concurrent Session – 12 May 2006

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Agenda

1. Explaining the Task Force
2. The Treasurer's Plan
   - Overview
   - Five discussion topics
3. Where to now?

Superannuation is complex but can now be simplified….

Complex system
- Cumbersome
- Hard to understand
- Sub-optimal economically

Major reform desirable but difficult

Co-contributions
No work test to age 65
Over 55 'transitioning'
Contribution splitting
New personal tax rates
Choice

Recent enhancements

Removal of surcharge

Opens the way to wider reforms

IAAust Task Force 'on the case'

Proposals for reform

Piecemeal changes tend to increase complexity

Task Force Activities

- **Developing and debating proposals**
  - Concentrate on basic framework plus options
  - Focus on simplification
  - Test with modelling
- **Discussing with Government**

Our goal has been tax reform rather than publicity

The Overall Goals

1. Simplify each of –
   - the tax treatment of contributions,
   - the taxes levied on superannuation funds, and
   - the taxation of benefits.
2. Create a coherent structure which facilitates future adjustments without grandfathering issues
3. Meet Government revenue requirements.
4. Create a more robust tax base in an ageing population.

Our Proposed Direction of Reform

1. Modify fund taxes and tax deductibility of contributions
2. Tax all superannuation benefits like other income
    - Encourages pensions over lump sums
    - Generates robust tax base in an ageing population
3. Allow appropriate recognition for fund taxes paid
4. Focus on contribution limits only (instead of RBLs)
5. Reduce complexity caused by cumulative "grandfathering"
    - Introduce a once-only transition for all accrued rights (being various past tax concessions and benefit options)
    - Aim for no members to be losers or major winners

The Current System ...

Contributions
- 4 tax regimes for contributions
- 2 tax systems inside a fund

Investment income
- 2 tax regimes inside funds

Contribution and benefit limits
- 3 regimes -
  age based conts, 2 RBLs

Benefit payments
- Lump sums: 11 tax rates
- Pensions: 2 tax rebates

A complete description shows many more complexities and many anomalies

The Treasurer's Plan …

Contributions
- 3 tax regimes for contributions
- 2 tax systems inside a fund

Investment income
- 2 tax regimes inside funds

Contribution and benefit limits
- 1 simple regime (with 2 limits)

Benefit payments
- Lump sums: 4 tax rates
- Pensions: 2 tax rebates

  but there remain complexities with death and disablement benefits

The Treasurer's Plan….

Contribution / Limits

- **RBLs abolished**
- **Age Based Deductibility abolished**
  All Employer conts deductible to Employers / Self employed
- **$50,000 limit (Employer /self employed conts).**
- **Employer contributions above $50,000 now taxed 45%**
  Total for all employers' conts
  DB notional conts reported
- **Limits on Undeducted $150k pa** (or $450k avgd over 3 years) RETROSPECTIVE

Tax Investment income

- **No change**

Benefits

- **over 60s - All benefits (lump sum or pensions) tax free**
  special rules for untaxed schemes
- **Under 60s – Same as current rules with "big bang"**
  - consolidation of grandfathered components
  - pensions new UPP components
- **Death Benefit changes**

Other

- **Assets tests more /less generous**
- **Income stream rules simplified**
- **Portability rules changed**
- **Consolidating lost super**
- **Co conts for self employed**

Table 2.1: Comparison of current system to proposed system

<table>
<tr><th>Component</th><th>Current tax treatment</th><th>Proposal</th></tr>
<tr><td>Pre-July 1983</td><td>5 per cent taxed at marginal rates</td><td rowspan="5">Exempt component</td></tr>
<tr><td>Concessional</td><td>5 per cent taxed at marginal rates</td></tr>
<tr><td>Undeducted contributions</td><td>Exempt</td></tr>
<tr><td>Post-June 1994 invalidity</td><td>Exempt</td></tr>
<tr><td>Capital gains tax exempt</td><td>Exempt</td></tr>
<tr><td>Non-qualifying</td><td>Marginal rates</td><td rowspan="2">Taxable component (see below)</td></tr>
<tr><td>Post-June 1983</td><td>Taxed as per table below</td></tr>
<tr><td>Excessive</td><td>38 per cent</td><td>Abolished</td></tr>
</table>

Taxable component

<table>
<tr><th>Taxpayers age</th><th>Current tax treatment (for post June 1983)</th><th>Proposal</th></tr>
<tr><td>Under 55</td><td>20 per cent</td><td>20 per cent</td></tr>
<tr><td>Age 55-59</td><td>Up to threshold ($129,751) — 0 per cent
Over threshold — 15 per cent</td><td>Up to threshold ($129,751) — 0 per cent
Over threshold — 15 per cent</td></tr>
<tr><td>Age 60 and over</td><td>Up to threshold ($129,751) — 0 per cent
Over threshold — 15 per cent</td><td>Exempt</td></tr>
</table>

Five Discussion Topics

1. Tax base in an ageing population?

2. New contribution limits (and no RBL)

3. Behavioural effects of changes?
   - Pensions and lump sums both tax free
   - Age Pension and means test changes

   Incentives after age 60 –
   To work?
   To spend?
   To save?

4. Preservation Age v Age 60

5. Taxes on investment income

Tax base in an Ageing Population?

Current government revenue -

- Contributions tax — $5bn (est)
- Investment income tax — $2bn
- Benefits — less than $½bn

Elimination is low cost option today

Will there be a government revenue problem in 20+ years?

- Task force thought yes → Increase benefit taxes, reduce fund taxes BUT REVENUE NOT SIGNIFICANT
- Treasurer says no? → Increase work force participation beyond age 60

New Limits

$50,000 deductible, $150,000 undeducted
***and* no age limits, no age variation, no work tests**

Is $50,000 deductible adequate? … in all circumstances, at all ages?

- **some need to catch up**
- **some need to fund early**
- **some need to fund intermittently**

Why $150,000 undeducted ? … is it enough, too much or too little?

- **Helpful if you have a lump sum to invest**
- **Not helpful to many working on wages or salary**

Administration of Limits

Under the Treasurer's Plan –

- **Super funds will pay taxes on excess contributions**

Our suggestion

- **Treat employer contributions as taxable income to employee**
- **Make contributions deductible to the individual (up to limit)**
- **Oblige funds to provide timely contribution statements (like group certificates)**

see example ….

Employer Contributions as Taxable Income

	Current System	Our Proposal
Employer -		
Salary	$100,000	$109,000
Super contribution	$9,000	-
Total employee expense	$109,000	$109,000
Employee -		
Salary	$100,000	$109,000
Dedn for Super Cont	-	($9,000)
Taxable Income	$100,000	$100,000

No change

Behavioural effects of changes?

The radical change:

pensions and lump sums become tax free from age 60

and

means tests for the age pension will change

--

Incentives after age 60: what will people do –

work? spend? save?

- **Will individuals spend up big?**

  ***or* will they plan better the draw down of benefits?**
- **Will work force participation increase after 60?**

Preservation age v Age 60

Under the Treasurer's Plan -

- **Benefits taken between 55 and age 60 – to be taxed**
  after age 60 – to be tax free
  - **Complicates planning for both full retirement and transition to retirement**
  - **Simpler when preservation age reaches 60**
    ***but* currently this will not occur until 2024**

Should the move to a preservation age of 60 be accelerated?
e.g. for all currently under age 50

Investment Earnings Tax – Needs Simplifying?

Earnings tax is not uniform –

- 15% (income) 10% (capital gains) on accumulation assets
- zero on pension assets

Having two rate structures -

- causes administrative complexity
- invites some investment and benefit manipulation

Under the Treasurer's Plan, with all benefits tax free,
is there a case for -

- one rate structure only for all assets?
- if so, a single rate of 15%? … 10%? …other ?
- no differential between income and capital gains?

The Task Force: where to now?

Prepare submission to Treasury

… due by 9 August 2006

- **Assess Plan against our criteria and ideas**
- **Consult with other Institute committees**
- **Resume dialogue with Treasury**