20 July 2010

Manager
Contributions and accumulation unit
Personal and Retirement and Income Division
The Treasury
Langton Cr, Parkes Place
Canberra ACT 2600

Dear sir/madam,
Re: Low income earners Government superannuation contribution

Please accept this letter as our short submission on the Low income-earners Government superannuation contribution. It deals with policy issues regarding the taxation of superannuation contributions though we acknowledge that the contribution was announced in the Government’s response to the Australia’s Future Tax System (AFTS) review.

Although the proposed superannuation contribution would raise the retirement savings of people on low incomes in the short term, we reluctantly conclude that it should not be introduced in its present form. We recommend that the co-contribution system proposed in the AFTS report be implemented instead, for two reasons. First, the AFTS proposal (described below) is a structural reform that would permanently simplify the superannuation system and improve its equity and target efficiency. By contrast, the proposed superannuation contribution would add another platform to a complex, inequitable and incoherent system without resolving its underlying flaws. Our second concern is that the introduction of this measure, along with the proposed increase in caps on annual concessional contributions, could delay indefinitely the kind of structural reform which we believe is necessary. This concern is informed by the history of piecemeal reform of the tax treatment of superannuation over the last 30 years.

The present system delivers more than a quarter of the $12 billion in annual tax concessions for contributions to the top 5% of income-earners while those on the lowest incomes do not benefit at all. The main source of these inequities is the interaction between progressive personal income tax scale and the flat 15% tax applied to concessional contributions. A number of attempts have been made by policy makers to offset the regressive impact of this feature of the present system including the superannuation surcharge (subsequently abolished), co-contributions for low income earners, and lower caps on concessional contributions (subsequently partially reversed). However, none attacked the problem at its source. Instead, they added to the system’s complexity and either arbitrarily increased concessions for low income earners or reduced them for high income earners in the absence of a coherent reform package. As a result the system remains complex and unstable and its underlying inequities are unresolved.

ACOSS supports, with a significant amendment, the AFTS proposal to replace the 15% contributions tax and other tax concessions for contributions with a simple rebate or co-contribution paid into superannuation funds annually. A key component of this reform is the taxation of employer contributions at the personal marginal rate of each fund member.
(rather than 15%), which could be achieved through the normal process of deduction of tax on employee earnings at source by the employer. In view of the Government's decision to increase compulsory employer superannuation contributions, our proposed amendment to the AFTS recommendation is to withdraw tax (at each employee’s marginal rate) from employer contributions to the superannuation fund rather than from current earnings. This would remove the ‘forced saving’ element of the AFTS proposal and leave each employee’s current disposable income unchanged. The rebate or co-contribution would be calculated as a percentage of annual contributions from all sources (including compulsory contributions) up to an annual flat-dollar cap. Ideally, a small component of annual contributions would be rebated at the rate of 100% to boost the retirement savings of those on the lowest incomes and to provide a substitute for the current co-contribution.

This structural reform would ensure that contributions for individuals at different levels of income and from different sources are treated equitably. The tax subsidy per dollar contributed would be the same for all contributions up to the annual cap. The cap would be designed to prevent public subsidisation of ‘luxury’ retirement living standards and to ensure that the reform is revenue neutral. This reform would also replace at least five separate tax treatments of different types of contributions with a single, transparent system of public support for retirement saving. The greater transparency of the proposed rebate or co-contribution is itself likely to encourage more private saving just the opaque nature of the present tax concessions discourages it.

Although it would improve equity in the distribution of tax concessions for superannuation in the short term, the proposed low income-earners Government contribution takes us in a different direction to the structural reform we believe is necessary and may postpone that reform indefinitely. It would also add to the cost of tax support for superannuation when the cost of reform could be fully met by reducing concessions for those on higher incomes as proposed in the AFTS report. It would add to the complexity of the system. Further, although the proposed contribution would offset the current tax penalty (the 15% contributions tax) for employer contributions made on behalf of individuals on the lowest incomes, the tax benefits of superannuation would still be greater for middle income earners (a saving of 16.5 cents per dollar invested on behalf of an individual on the 30% tax rate) and higher again for those on the top marginal tax rate (a tax saving of 31.5 cents per dollar invested).

The AFTS proposal, amended as discussed above, is a fairer and simpler solution.

Should you have any queries about this submission, please contact either myself or our Senior Policy Officer Peter Davidson at this office. We are happy for this submission to be uploaded to the public website.

Yours sincerely

Dr Tessa Boyd-Caine
Acting Chief Executive Officer
Australian Council of Social Service