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Mr John Lonsdale
General Manager
Superannuation, Retirement and Savings Division
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Mr Lonsdale

A PLAN TO SIMPLIFY AND STREAMLINE SUPERANNUATION

The Office of Small Business in this Department has a charter to provide policy advice and support to the Government on small business issues. One of its key roles is to consult with small businesses and their representative bodies on issues of concern.

The enclosed submission was provided to the House of Representatives Standing Committee on Economics, Finance and Public Administration with an outline of some key small and medium enterprise issues that have come to the attention of the Office of Small Business, which were considered relevant to the terms of reference of the *Inquiry into improving the superannuation savings of people under 40*. The submission reflects the views of small business stakeholders on superannuation savings issues that have been brought to our attention.

The Department would like to provide a copy of this submission to assist in relation to the consultation process for the proposed superannuation changes effective from 1 July 2007 as outlined in the Government's *A plan to simplify and streamline superannuation*.

Yours sincerely

A handwritten signature in cursive script, appearing to read 'Sue Weston'.

Sue Weston
Division Head
Office of Small Business

29 May 2006



Australian Government

**Department of Industry
Tourism and Resources**

**Office of Small Business Submission
House of Representatives Standing Committee on Economics, Finance and
Public Administration
Inquiry into Improving the Superannuation Savings of People under 40**

Introduction

1. The Office of Small Business, as part of the Department of Industry, Tourism and Resources, seeks to promote the increased prosperity of all Australians through internationally competitive and sustainable business. The Office of Small Business is a focal point for the development and consideration of small business policy issues within Government. It provides policy advice and support to portfolio Ministers on small business issues and fosters an understanding across Government of the critical factors influencing the growth of small firms and the small business sector generally. It is in this context that this submission is made.
2. This submission is intended to provide the House of Representatives Standing Committee on Economics, Finance and Public Administration ('Standing Committee') with an outline of some key small and medium enterprise issues that have come to the attention of the Office of Small Business, which are considered relevant to the terms of reference of the *Inquiry into improving the superannuation savings of people under 40*. The key issue relates to the incentive for unincorporated self-employed small business operators to save for their retirement through superannuation, given that they fall outside the compulsory Superannuation Guarantee requirements.
3. The Inquiry into improving the superannuation savings of people under 40 is to have particular reference to:
 - Barriers and/or disincentives to contribute to superannuation.
 - Current incentives in place to encourage voluntary superannuation contributions.
 - Improving their awareness of the importance of saving early for their retirement.

Background small business and the self-employed

4. More than 96% of businesses are small businesses and they provide employment for almost 3.3 million people, accounting for almost half (47%) of private sector, non-agricultural employment in 2001. In that year it was estimated that there were on average 582,100 non-employing small businesses in Australia, representing 52% of total non-agricultural small business.¹

¹ Australian Bureau of Statistics 2002, *Small Business in Australia 2001*, Cat no 1321.0, ABS Canberra

5. Corporation law reforms since the mid 1990's, particularly the removal of the requirement for proprietary companies to have two shareholders, have made it easier for the self-employed to operate through a company structure.

6. The nation's workforce has continued to evolve, shaped by a number of factors including the economic environment, increased workplace flexibility and trends like outsourcing, which have provided a continuing role for self-employment options.

7. An examination of ABS data from 2004 on forms of employment indicated that there were an estimated 301,200 owner managers of incorporated enterprises aged between 20 and 44 years of age (92,900 between 20 and 34) and 607,400 in the same age category of owner managers of unincorporated enterprises (273,000 between 20 and 34) (see Attachment A Table 1).

8. The data also suggests that employed persons in older age groups are more likely to be in self-employment arrangements (either as owner manager of an incorporated or unincorporated enterprise) as a proportion of total employed in their peer age group (see Attachment A, Table 2). The self-employed accounted for around 14.5% for those in the 25-34 age group and almost one quarter of those in 35-44 age bracket.

9. Around 20% of owner managers without employees had a company structure in 2004 (see Attachment A, Table 3). Time series data from 1992 to 2003 suggests a slight shift from owner management of unincorporated enterprises to incorporated enterprises over that period (see Attachment A, Table 4).

10. An ABS survey on superannuation coverage in 2000 showed that some 37% of owner managers of unincorporated enterprises had no superannuation, the highest of all employment types, whereas 13% of owner-managers of incorporated enterprises had no superannuation. Owner managers of unincorporated enterprises that did have superannuation had much lower median superannuation account balances. For example, their median accumulation account balance was 45% of that of owner managers of incorporated enterprises (see Attachment A, Tables 5 and 6).

Superannuation and small business operators

11. Superannuation contributions compete with many other priorities for available funds such as home ownership, family commitments, higher education contribution scheme repayments and investing in their business. The Government's small business capital gains tax concessions do recognise that investing in the business may take priority over retirement savings.

12. However, those unincorporated self-employed small business operators who wish to contribute to superannuation instead, have expressed concerns about the treatment of their superannuation contributions for the purposes of tax deductibility and the Government co-contribution.

Superannuation deductibility and small business

13. Unincorporated self-employed business operators and their representative bodies have voiced concerns about their inability to obtain the same level of taxation deductions that would be available if they were to restructure their affairs to operate the business as a company.

14. Under current arrangements, the unincorporated self-employed are entitled to a tax deduction equal to the first \$5,000 of superannuation contributions plus 75% of the amount contributed in excess of this, or the applicable age-based deduction limit, whichever is the lesser. By contrast, owner managers employed by their small business companies have full access to the age-based deduction limits as these are generally fully deductible to the company employing them. The age-based deduction limits for 2004-05 were \$13,934 for those under 35, \$38,702 for those 35 to 49 years of age and \$95,980 for those aged 50 and over.

15. Members of the Small Business Council, and its predecessor, the Small Business Consultative Committee, have considered this differential treatment, suggesting that it appears to be inequitable for business operators to be subjected to separate superannuation deductibility arrangements purely because they operate under different business structures. Bringing the deductibility level of self-employed business operators in line with those of companies would also provide a stronger incentive for self-employed people to contribute to superannuation. Both these consultative bodies were established to provide the Minister for Small Business with advice on small business issues and comprised small business operators, some of whom are practicing accountants.

16. The major accounting and tax agent bodies, CPA Australia, the Institute of Chartered Accountants in Australia, and the National Institute of Accountants have also argued for consistency in the tax treatment of superannuation contributions to reduce complexity in this area.

17. For example, in its 2005-06 pre-Budget submission, CPA Australia argued that *“Superannuation contributions by self-employed should be fully tax deductible up to the age-based limits”*. The Institute of Chartered Accountants expressed the same views in its 2005-06 pre-Budget submission stating that *“The Government should bring the tax treatment of contributions and invalidity payments of the self-employed into line with that of employed people.”*

18. Small business operators have also made representations in their own right on this issue. For example, one small business owner who queried why sole traders and partnerships did not receive the same benefits that companies and employees do, stated:

“if there was more incentive for us to put our money into our super rather than plough it all back into our businesses, more sole traders and partnerships would put away and save for their old age future.”

19. Another small business operator stated “on the issue of superannuation (if) the Federal Government does include sole traders and partnership operators equally within the superannuation system that would assist in securing the future of these hardworking individuals who are taking strain off the unemployment and government benefits of this country by working for themselves”.

20. The provisions governing deductibility for contributions by those without employer supported superannuation were introduced by the *Income Tax Assessment Act (No 4) 1980*. The original provision was for a deduction up to \$1,200. The explanatory memorandum for the respective bill notes that “[S]elf-employed persons and persons otherwise engaged in gainful occupations but for whom superannuation benefits are not supported by an employer or anyone else, are not entitled to tax deductions for their personal contributions but are entitled to the same tax concessions for such contributions as supported employees are for theirs. ... The position is proposed to be changed by [introducing] a new income tax deduction under section 82AAT for ‘unsupported’ persons who make provision for their own retirement by contributing to a qualifying superannuation fund.”²

21. Age-based deduction limits were introduced by *Taxation Laws Amendment Superannuation Act 1992*³, including adding an age-based cap on deductions for the unincorporated self-employed. In its submission to the Senate Select Committee on Superannuation Inquiry into Superannuation and Standards of Living in Retirement in July 2002, the Treasury noted that “The age based limit system, together with the Reasonable Benefit Limit (RBL) arrangements, is designed to impose limits on the amount of superannuation which can receive concessional taxation treatment. The policy intention behind these limits is to ensure that superannuation is used for its intended purpose of providing for genuine retirement income, and not as a wealth creation or estate planning vehicle.”

22. It may be appropriate, for policy reasons, to restrict access to superannuation concessions to those contributing to superannuation from earnings from their own efforts rather than accumulated wealth. However, the unincorporated self-employed would argue that the means to achieving those ends, in terms of the structure of the provision resulting from the 1980 and 1992 amendments, may warrant revisiting to ensure it also meets the Government’s objectives for self-provision of retirement income by the unincorporated self-employed in the context of a modern, flexible workforce. Some representatives of the sector argue that there are other ways to meet the underlying policy objectives of the provision.

Superannuation co-contribution and small business

23. Where income falls within the low levels that might attract the Government co-contribution, personal contributions by the unincorporated self-employed are generally ineligible. Essentially, the eligibility conditions require that 10% or more of the person’s total income be from working arrangements that result in them being treated as an employee for superannuation guarantee purposes. Affected small business operators have questioned this on the basis that those able to structure their affairs through a

² Harris v Commissioner of Taxation [2002] FCAFC 226 at 18

³ Harris v Commissioner of Taxation [2002] FCAFC 226, at 21

company so as to be treated as an employee, can be in a position to access the co-contribution.

24. The revised explanatory memorandum to the Superannuation (Government Co-contribution for Low Income Earners) Bill 2002 indicates that the purpose of the tests relating to employer support are to ensure that a person cannot receive a deduction for eligible personal superannuation contributions and also receive a Government co-contribution. The unincorporated self-employed forgoing deductions on part of the contributions they make feel particularly aggrieved about the operation of the co-contribution rules. As one correspondent put it, *“As the Superannuation co-contribution currently stands, Sole Traders and Partnerships are the ones who are not rewarded for the work that they are doing when it comes (to) superannuation.”*

Conclusion

25. The ranks of the unincorporated self-employed are a vital breeding ground for innovative, entrepreneurial firms. Some will go on to employ and incorporate and some will not.

26. As outlined in this submission, unincorporated self-employed business operators that have tried to set aside money into superannuation earlier in life, when they are still struggling to establish their businesses, have reported that they are unassisted by the operation of the co-contribution scheme. For many, financial pressures may not sufficiently ease before they are in their 30's to early 40's. Unincorporated self-employed business operators attempting to make up for lost time with larger superannuation contributions have voiced their frustration on discovering that they operate under different income tax deductibility rules.

27. In this regard, the income tax deductibility of the contributions of the self-employed relative to other taxpayers and the co-contribution scheme rules can be said to represent a disincentive to contribute to superannuation in the age group being considered by the Committee. Addressing this may need to take into account any necessary interaction with the small business capital gains tax retirement exemption.

Table 1. Employed persons: form of employment by age group

| Age Group Years | Employees (^{'000}) | Owner Managers of Incorporated Enterprises (^{'000}) | Owner Managers of Unincorporated Enterprises (^{'000}) | Total (^{'000}) |
|--------------------|----------------------------------|--|--|------------------------------|
| 15-19 | 669.4 | *1.1 | 7.4 | 677.9 |
| 20-24 | 996.8 | 5.9 | 40.8 | 1043.5 |
| 25-34 | 1878.1 | 87 | 232.2 | 2197.3 |
| 35-44 | 1746.1 | 208.3 | 334.4 | 2288.8 |
| 45-54 | 1618.7 | 221.9 | 317 | 2157.6 |
| 55-59 | 514.6 | 83.9 | 138.5 | 737 |
| 60-64 | 235.5 | 46.1 | 80.5 | 362.1 |
| 65 & over | 73.9 | 33 | 69.9 | 176.8 |
| | 7733.1 | 687.2 | 1220.7 | 9641 |

* estimate has a relative standard error of 25% to 50% and should be used with caution

Extract from Australian Bureau of Statistics May 2005, *Forms of Employment, Australia, November 2004*, Cat no 6359.0., Table 2

Table 2. Employed persons: form of employment, as a percentage of total employment in age group

| Age Group Years | Employees | Owner Managers of Incorporated Enterprises | Owner Managers of Unincorporated Enterprises | Total self employed | Total |
|-----------------------|-----------|---|---|------------------------|-------|
| 15-19 | 98.75% | 0.16% | 1.09% | 1.25% | 100% |
| 20-24 | 95.52% | 0.57% | 3.91% | 4.48% | 100% |
| 25-34 | 85.47% | 3.96% | 10.57% | 14.53% | 100% |
| 35-44 | 76.29% | 9.10% | 14.61% | 23.71% | 100% |
| 45-54 | 75.02% | 10.28% | 14.69% | 24.98% | 100% |
| 55-59 | 69.82% | 11.38% | 18.79% | 30.18% | 100% |
| 60-64 | 65.04% | 12.73% | 22.23% | 34.96% | 100% |
| 65 & over | 41.80% | 18.67% | 39.54% | 58.20% | 100% |

Derived from Australian Bureau of Statistics May 2005, *Forms of Employment, Australia, November 2004*, Cat no 6359.0, Table 2

Table 3. Owner managers and whether they have employees

| Owner managers of incorporated enterprises | (^{'000}) |
|---|---------------------|
| has employees | 432.1 |
| does not have employees | 244.9 |
| Owner managers of unincorporated enterprises | |
| has employees | 288.3 |
| does not have employees | 901.4 |

Extract from Australian Bureau of Statistics 2005, *Forms of Employment, Australia, November 2004*, Cat no 6359.0, Table 1

Table 4. Employed persons, distribution by type of employment – 1992 to 2003

| Month | Employees with paid leave entitlements(a) | Employees without paid leave entitlements(a) | Owner managers of incorporated enterprises | Owner managers of unincorporated enterprises | Contributing family workers | Total | Total |
|--------|---|---|---|---|-----------------------------------|-------|---------|
| | % | % | % | % | % | % | '000 |
| August | | | | | | | |
| 1992 | 62.0 | 16.9 | 4.9 | 15.2 | 1.0 | 100.0 | 7,636.7 |
| 1993 | 61.8 | 17.1 | 4.6 | 15.6 | 0.9 | 100.0 | 7,636.3 |
| 1994 | 61.0 | 17.8 | 5.1 | 15.0 | 1.0 | 100.0 | 7,897.4 |
| 1995 | 61.2 | 18.0 | 5.2 | 14.7 | 0.9 | 100.0 | 8,231.3 |
| 1996 | 60.4 | 19.5 | 5.7 | 13.4 | 0.9 | 100.0 | 8,332.8 |
| 1997 | 59.6 | 19.0 | 5.7 | 14.7 | 0.9 | 100.0 | 8,324.3 |
| 1998 | 59.7 | 19.8 | 6.6 | 13.1 | 0.8 | 100.0 | 8,555.6 |
| 1999 | 59.5 | 19.7 | 5.6 | 14.3 | 0.9 | 100.0 | 8,692.1 |
| 2000 | 59.3 | 20.0 | 6.2 | 13.6 | 0.9 | 100.0 | 8,990.3 |
| 2001 | 59.3 | 19.8 | 6.8 | 13.7 | 0.4 | 100.0 | 9,061.9 |
| 2002 | 59.3 | 19.9 | 6.5 | 13.9 | 0.4 | 100.0 | 9,244.3 |
| 2003 | 59.5 | 20.4 | 6.8 | 13.0 | 0.3 | 100.0 | 9,396.5 |

(a) Excluding owner managers of incorporated enterprises

Extract from Australian Bureau of Statistics, 2004, *Australian Labour Market Statistics*, Cat no 6105.0

Table 5: Jobholders, type of superannuation coverage of persons

| Selected characteristics | Employer/business contributions only | Personal spouse and employer/business contributions | Personal/spouse contributions only | Has superannuation, but no contributions currently being made | No superannuation | Proportion | Number |
|---|--------------------------------------|---|------------------------------------|---|-------------------|------------|--------|
| | % | % | % | % | & | % | ('000) |
| Age group (years) | | | | | | | |
| 15-24 | 58.7 | 6.5 | 0.9 | 7.9 | 26 | 100.0 | 1563.2 |
| 25-34 | 61.7 | 18.9 | 2.1 | 9.7 | 7.6 | 100.0 | 2128.6 |
| 35-44 | 49.3 | 27.9 | 4.7 | 8.6 | 9.5 | 100.0 | 2257.0 |
| 45-54 | 43.8 | 32.4 | 6.7 | 7.7 | 9.5 | 100.0 | 1937.9 |
| 55-69 | 39.6 | 25.2 | 7.5 | 8.0 | 19.8 | 100.0 | 840.9 |
| Employment type in main job: | | | | | | | |
| Employees with leave entitlements, not working on a fixed-term contract | 58.5 | 36.1 | 1.0 | 2.1 | 2.2 | 100.00 | 4801.5 |
| Employees with leave entitlements, working on a fixed-term contract | 66.7 | 23.7 | *2.0 | 4.1 | *3.4 | 100.0 | 286.0 |
| Self-identified casuals | 53.7 | 4.7 | 1.3 | 12.3 | 28.0 | 100.0 | 1596.4 |
| Employees without leave entitlements that did not identify as casual | 49.1 | 9.1 | *5.6 | 17.4 | 18.8 | 100.0 | 159.9 |
| Owner managers of incorporated enterprises | 60.3 | 6.4 | 7.9 | 12.4 | 13.0 | 100.0 | 660.1 |
| Owner managers of unincorporated enterprises | 15.5 | 3.0 | 18.4 | 26.1 | 37.1 | 100.00 | 1223.7 |

* estimate has a relative standard error of 25% to 50% and should be used with caution

Extract from Australian Bureau of Statistics, 2001, *Superannuation Coverage and Financial Characteristics, Australia April to June 2000*, Cat no 6360.0, Table 9

Table 6: Pre-retired persons with superannuation, median account balances

| Selected characteristics | Accumulation account balance | Withdrawal/resignation benefit amount | Total superannuation balance |
|---|------------------------------|---------------------------------------|------------------------------|
| Age group (years) | \$ | \$ | \$ |
| 15-24 | 942 | 1942 | 1021 |
| 25-34 | 5579 | 12025 | 7016 |
| 35-44 | 9241 | 29605 | 12760 |
| 45-54 | 14596 | 47015 | 21299 |
| 55-69 | 22543 | 49101 | 29962 |
| Employment type in main job: | | | |
| Employees with leave entitlements, not working on a fixed-term contract | 8703 | 30439 | 12866 |
| Employees with leave entitlements, working on a fixed-term contract | 4279 | 7992 | 5592 |
| Self-identified casuals | 2102 | 3012 | 2279 |
| Employees without leave entitlements that did not identify as casual | 5123 | *8262 | 5238 |
| Owner managers of incorporated enterprises | 23995 | *16673 | 25000 |
| Owner managers of unincorporated enterprises | 10861 | 8793 | 11247 |
| Not a jobholder | 3100 | 6768 | 3469 |

* estimate has a relative standard error of 25% to 50% and should be used with caution
 Extract from Australian Bureau of Statistics, 2001, *Superannuation Coverage and Financial Characteristics, Australia April to June 2000*, Cat no 6360.0, Table 10