

Submitted By: Christopher Moore
Qualifications: Private Capacity
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Contact: chrismoore@people.net.au

A PLAN TO SIMPLIFY AND STREAMLINE SUPERANNUATION

It would appear that the *simpler super* proposal offers little for under 40's in the accumulation phase of saving for retirement. The only benefit is

- the increase in maximum deductible contributions up to \$50,000 per year
- making it easier to find and transfer superannuation accounts.

Considering that many young Australians do not contribute up to the old \$14,000 let alone knew about it, it is doubtful whether the *simpler super* proposal will change the behaviour of young Australians to increase voluntary contributions.

Although the *simpler super* proposal does reduce complexity and provide the flexibility to continue working for older Australians, it does not address the problem of insufficient superannuation contributions from younger Australians to meet the expectation gap and reduce future age pension payments, especially those 30 to 50 years from retirement.

Recently the Standing Committee on Economics, Finance and Public Administration (EFPA) conducted an inquiry into improving savings of people under age 40. A number of submissions made the point that accessibility to superannuation was a barrier to place voluntary contributions into superannuation for those under age 40. (Ironically, including Treasury). Most of the younger generation who do invest for the long-term place their money in managed funds, shares and property outside of preserved super.

The younger generation, who will have accumulated 40 years of the 9% super guaranteed, will see their retirement funds greatly enhanced as shown from the *simpler super* proposal that states a couple aged 25 with a combined \$1200 p/wk income would provide \$549,763 at age 65. Both couples's incomes are well below average weekly earnings. An individual on average weekly earnings working 40years would accumulate \$466,000 from the 9% super guarantee alone.

At the EFPA inquiry the Australian Superannuation Funds Association (ASFA) submitted that \$500,000 provides a 'comfortable' lifestyle for a couple. It would appear then that the 9% SG will provide at least a 'modest' to 'comfortable' lifestyle, for a significant portion of the population. For those that do not achieve this level, they now have the opportunity thanks to the new *simpler super* proposal to keep working in retirement.

It would seem somewhat irrational then for the need to preserve voluntary contributions that will really only make up the expectation gap, which is the 'nice to have' part of a retirement lifestyle, especially for those who will have 40 years of the 9% super guarantee.

Because most young Australians contribute outside super in negative geared property and shares, it would appear the changes to contribution limits would affect those whose strategy was to sell up and make a large tax-deductible contribution to superannuation in the year before retirement. This will mean young Australians who continue to invest outside superannuation because of preservation of voluntary contributions, will have their retirement savings reduced. If the *simpler super* changes are made to do this, it is still unlikely any behaviour change will occur, especially for those 20years or more from retirement.

If government wants people to contribute a substantially higher percentage of around 10% to 20% of gross income over a 30 to 40 year period to meet the expectation gap, accessibility is paramount. Lack of access to funds is a significant disincentive because it is impractical and inflexible to fit in with working life, especially those who work casual or on contract that regularly have periods of no income. Hence the uncertainty and the need to keep their money in liquid investments that are taxed at marginal rates.

An attractive solution to improve voluntary contributions would be to create a **Super Accessible Voluntary Account (SAVA)**. The tax treatment of the account would be identical to current superannuation funds, but would be accessible. The account would be separate from preserved superannuation and would obviously not carry any grandfathered components that have created the complexity we have today.

Super Accessible Voluntary Account (SAVA)

The account would work on the principle that if money is left in the account it receives the superannuation tax concessions, but if the money is accessed the tax concession is lost and the original gross income is taxed at the marginal rate from the year it was first contributed, and earnings would be taxed at the current years marginal tax rate.

For salary sacrifice and undeducted contributions, individuals would have to apply to their employer to change their contributions into the SAVVA account. The default would still remain with preserved superannuation.

The account would be designed with six (6) components as follows

1. 45% Tax Bracket
2. 40% Tax Bracket
3. 30% Tax Bracket
4. 15% Tax Bracket
5. Undeducted Contributions
6. Earnings

During the accumulation phase, salary sacrificed contributions would be placed into the tax bracket they were earned from. So salary sacrificed contributions from average weekly earners (\$50,000p.a. salary) would be placed into the 30% Tax Bracket component. Contributions from post-taxed elements would sit in the undeducted contributions component.

Access to (components 1 to 4) would see the balance grossed up with a 15% tax credit and then applied with an exit tax at the tax bracket the money is sitting in.

Access to undeducted contributions (component 5) would be tax free upon withdrawal.

Access to earnings (component 6) would be grossed up with a 15% Tax credit and added to the persons marginal tax rate in the year of withdrawal, similar to dividend payments from shares.

Because it is not a superannuation fund, it would not accept co-contribution payments and would not allow income splitting.

Contribution limits of the proposed \$50,000 for salary sacrificed and \$150,000 for undeducted contributions could be applied to both contribution and withdrawal limits on the SAVVA account to simplify the operation and to keep it inline with the superannuation policy.

The following is an example of how it may work.

Table 1

Gross Income	Net Income	Tax Brackets	SAVA ACCOUNT	Accessible
\$ 10,000		45%	\$ 8,500	\$ 5,500
\$ 10,000		40%	\$ 8,500	\$ 6,000
\$ 10,000		30%	\$ 8,500	\$ 7,000
\$ 10,000		15%	\$ 8,500	\$ 8,500
	\$ 7,000	Undeducted Contributions	\$ 7,000	\$ 7,000
		Earnings	\$ -	\$ -
			\$ 41,000	
				\$ 34,000 Cash in Hand
				\$ - Added to taxable Income
				\$ - Tax Credit (Tax Paid)

Table 1 shows salary-sacrificed contributions of \$10,000 at different tax brackets and a \$7000 undeducted contribution. The SAVA account column shows a \$41,000 balance, but the accessible column shows the balance of \$34,000 after exit taxes. Showing the accessible column with lower amounts creates a disincentive to access the funds. It also highlights the tax saved.

Upon accessing the money, for example the \$8500 from the 45% Tax Bracket component would be grossed up with a \$1500 tax credit to \$10,000. Then a 45% exit tax is applied leaving \$5,500 to the recipient. Because \$1500 tax has already been paid, the outstanding amount of tax owed is \$3000. The fund manager would handle all of this. Hence there is no complexity for the user, except to maybe log onto the Internet and make a withdrawal to their bank account.

Table 2

Gross Income	Net Income	Tax Brackets	SAVA ACCOUNT	Accessible
\$ 10,000		45%	\$ 8,500	\$ 5,500
\$ 10,000		40%	\$ 8,500	\$ 6,000
\$ 10,000		30%	\$ 8,500	\$ 7,000
\$ 10,000		15%	\$ 8,500	\$ 8,500
	\$ 7,000	Undeducted Contributions	\$ 7,000	\$ 7,000
		Earnings	\$ 500,000	\$ 588,235
			\$ 541,000	
				\$ 34,000 Cash in Hand
				\$ 588,235 Added to taxable Income
				\$ 88,235 Tax Credit (Tax Paid)

Table 2 shows an example of the contributions and earnings after say 40years.

Components 1 to 5 have not changed. The earnings component has increased, but if accessed would be grossed up with a 15% Tax credit and added to the persons taxable income in the year of withdrawal. Limitations could be enforced on withdrawals. A suggestion would be to use the contributions limits for superannuation.

Even though the account has 6 components there is no complexity for the user as the account would simply show two balances i.e. 'before access', and 'after access'.

Upon reaching age 60, access to the SAVA account would be tax-free.

Benefits

The liquidity of a tax effective savings vehicle provides an incentive to increase contributions.

The SAVA account is designed to provide the same return as a managed fund if money is accessed, but provides the incentive that if the money is left untouched until age 60, a higher retirement balance is achieved.

Younger Australians 30 to 50 years from retirement would have the flexibility and confidence to contribute 10%, 20% and even 30% of their income for retirement savings on top of their preserved 9% super guaranteed contribution from their employer that would appear to be from the *simpler super* proposal to provide near enough to a 'comfortable' lifestyle.

Extra mortgage repayments could be re-directed towards the SAVA account. Meaning the SAVA acts as a redraw facility and thus a lower rate home loan without a redraw facility can be used. That would therefore mean salary sacrificed contributions are earning a high rate of return in growth assets, rather than after tax dollars earning the lowest rate mortgage.

Those who pay off their home loan often look for other investments that grow faster as an after tax return than their mortgage rate. Superannuation is one investment that achieves this, but because of preservation of voluntary contributions and earnings, they dismiss its usefulness. If a savings vehicle such as the SAVA account were implemented younger Australians would have the opportunity and incentive to change their savings and debt behaviour. The SAVA account is also likely to invoke a response from financial commentators in the media, that directing extra repayments towards the mortgage for younger Australians is a poor choice to increase retirement savings. (For an example see Appendix A).

Those with erratic work patterns, mainly casual and contract workers have the confidence to contribute large portions of their salary into the SAVA account. During periods of unemployment, they have the flexibility to draw down on their account to provide a short-term income until their next job. (See Appendix B).

Disadvantages

It could be argued that capital gains within the SAVA Account would not enjoy the 50% reduction of capital gains rule when earnings (component 6) are accessed. It would appear that this is only the case if the capital gains are made from undeducted contributions.

Calculating the difference of capital gains held for more than 12 months accessed from a managed fund versus accessed earnings (component 6) made from salary-sacrificed contributions only is shown as follows:

- 45% Tax Bracket - 4.3% in front using the SAVA Account.
- 40% Tax Bracket - 2.1% in front using the SAVA Account
- 30% Tax Bracket - -2.6% worse off using the SAVA Account
- 15% Tax Bracket - -9.1% worse off using the SAVA Account.

These calculations assume capital gains within the SAVA account are taxed at 10%, and Grossed up with 15% tax credit when accessed.

The data suggests that the difference between accessing capital gains from managed funds and capital gains from the SAVA Account is marginal. Reason being is that salary sacrificed contributions in the SAVA account start with a higher amount of capital working for them, therefore greater earnings. But 100% of the greater earnings are taxed at the marginal rate when accessed.

Money invested in managed funds is post tax money hence a lower starting balance and thus lower earnings. The lower balance of capital gains (held for more than 12 months) from the managed fund receives a 50% reduction. This reduction helps to bring both scenarios within a 4.3% difference for the 45% Tax bracket.

Therefore capital gains made from salary sacrificed contributions within the SAVA account would not be disadvantaged by not having the 50% reduction. They are marginally in front for the two highest tax brackets.

Capital gains held longer than 12 months made from undeducted contributions within the SAVA account would be disadvantaged compared to managed funds, as they would not receive the 50% capital gains reduction when accessed, as they would be treated as straight income.

Complexity

From a users perspective this type of account with multiple tax brackets would be no different than having an account at a bank that has multiple credit card, mortgage and savings accounts. The user can easily identify what each component means.

Money is simply contributed into the account upon which the fund manager takes out contribution taxes. The account would then show a balance of before and after exit taxes. Upon accessing funds, the fund manager would pay the exit taxes meaning the user does nothing, Although if accessing earnings (component 6) the user would add this to their tax return at the end of the year, which is no different from receiving dividend payments.

Because the fund manager does all the tax calculations each year, this reduces the complexity for the user of filling out their tax return each year.

Complexity may lie in the administration side, as fund managers would have to know what tax bracket the salary-sacrificed contribution came from. This may require changing how gross income before and after salary sacrificing is reported each year to the ATO, to ensure contributions are placed into the correct tax bracket component of the SAVA account. The fund manager would also report contributions received to the ATO, who would then cross check, and make adjustments to the tax brackets (**tax bracket compression**) when calculating final income tax at the end of the financial year.

Tax Bracket Compression

This adjustment of tax brackets may be another point of administrative complexity. Other income earned such as bank interest that is added to the persons tax return at the end of the year, would mean that salary sacrificed contributions would be placed in the wrong tax bracket earlier in the year. This complexity could be overcome by compressing the tax bracket to an amount equivalent of salary-sacrificed contribution at the end of the financial year.

Example

A person with a salary of \$100,000 and \$15,000 of bank interest, salary sacrifices \$50,000 per year into the SAVA account.

Treatment of the person's income if the salary sacrifice was made to a super fund, using the 2006/07 Tax Tables, is as follows.

The \$15,000 interest would be taxed at 40% without the salary sacrifice. After salary sacrifice, the \$15,000 interest would be taxed at 30%, because the gross income is below \$75,000.

The 2006/07 Tax Tables

0-6,000	0% Tax
6,000 – 25,000	15% Tax
25,000 – 75,000	30% Tax
75,000 – 150,000	40% Tax
>150,000	45% Tax

The following is a way of ensuring proper tax treatment when salary sacrificing into the SAVA account.

0-6,000	0% Tax	
6,000 – 25,000	15% Tax	
25,000 – 50,000	30% Tax	(Tax bracket compressed by \$25,000)
50,000 – 100,000	40% Tax	(Tax bracket compressed by \$25,000)
> 100,000	45% Tax	

The \$25,000 to \$75,000 tax bracket is compressed by the same amount that is contributed to the 30% Tax bracket in the SAVA account.

The \$75,000 to \$150,000 tax bracket is also compressed by the same amount that is contributed to the 40% Tax bracket in the SAVA account. The \$75,000 is also reduced back to \$50,000.

After salary sacrificing, the persons income has dropped to \$50,000 + \$15,000 interest. The compression of the tax brackets ensures the \$15,000 is still taxed at 40%. This would be required because the salary-sacrificed contribution is not preserved and could be accessed at a later date.

Other Impacts

- Because the account is new, accessibility to voluntary contributions will not cause any adverse impact on specific parts of the economy, especially housing.
- No changes to existing super funds would be required.
- The design of the SAVA account allows Government to partially hedge against future dissipation. Meaning withdrawals would increase tax revenue for future governments.

Preservation

The whole idea that preservation ensures that contributions are used for retirement income seems incorrect. Preservation only ensures that money is available at age 60. It would appear that the only policies of ensuring contributions are used as retirement income is the use of tax incentives. i.e. if the money is left in super or income streams there is no tax on the withdrawal. But if invested outside, all withdrawals are added to the retiree's taxable income.

This same policy should be applied to voluntary contributions for younger Australians. This could be achieved if an accessible tax effective vehicle such as the SAVA account was feasible. i.e. if money is left in the account it retains the tax concession, but if withdrawn the tax concession is lost, and is taxed at the original marginal tax rate.

Conclusion

The *simpler super* proposal put forward appears to be a relaxation of policy of end benefits to encourage Australians to increase savings for retirement. This same stance should be taken on the preservation of voluntary contributions and earnings, to encourage younger Australians to contribute savings for retirement. The idea of a SAVA account is intended to overcome the obstacle of preservation without sacrificing government tax concessions and introducing complexity to the existing superannuation system.

APPENDIX – A

Example showing the advantage of Salary Sacrificing extra mortgage repayments into the SAVA Account

Person A –

Takes a \$300,000 home loan with a redraw facility at **6.75%** - makes repayments at \$2500\month. The minimum repayments are \$1945\month but an additional repayment of \$555\month is added.

Person B –

Takes a \$300,000 home loan over 30 years with no redraw facility at **5.75%** - makes repayments at the minimum \$1751\month and salary sacrifices the difference between \$2500 and \$1751 in repayments (\$909.5\month after 15% contributions tax into the SAVA).

*Both Person A & B are in the 30% Tax Bracket
Earnings after tax on Salary Sacrificed amounts are at 8%p.a.
Inflation 3% p.a.*

Result after 16Years & 10 months

Person A – Owns a Home

Person B – - \$194,507 still owing on loan,
+ \$374,234 in SS Contributions and Earnings,
Meaning a net balance of \$179,727 or \$109,553 in today's dollars.

Person B is in front by \$109,000 in today's dollars.

From then on after 16years & 10 months

Person A – Then Salary Sacrifices repayments into Super at \$3035\month

Person B – Still on repayments of \$1751 and salary sacrifices the difference between \$2500 and \$1751 in repayments (\$909.5\month).

*Both Person A & B are in the 30% Tax Bracket
Earnings after tax on Salary Sacrificed amounts are at 8%p.a.
Inflation 3% p.a.*

Result after 30Years

Person A – Owns a Home + \$343,287 (today's dollars) in the SAVA Account

Person B – Owns a Home + \$531,361 (today's dollars) in the SAVA Account

Person B has \$188,000 more in retirement funds in today's dollars. Yet both spent identical amounts over 30years.

The strategy of using 85% of gross income earning the highest rate of return achieved a higher level of savings than using 70% of gross income earning the lowest rate of return.

After 16 years, Person B has \$374,000 in their SAVA account that is accessible. If this amount were in a superannuation fund, the whole account would be inaccessible, meaning a young couple that contribute a large amount towards a higher return investment have no liquidity for unexpected emergencies. Person A has the same goal with accessibility to funds, but unfortunately a lower balance of retirement.

APPENDIX - B

Example showing the advantage of Salary Sacrificing into the SAVA account for contract workers with irregular work patterns.

A person on a 3-year contract earning \$50,000 per year, salary sacrifices \$25,000 per year and only requires \$25,000 for expenses. This person has no work in the 4th year and draws down the equivalent of \$25,000 gross income from the SAVA account. Then obtains a further 3 year contract earning \$50,000 per year, and salary sacrifices \$25,000 per year. No earnings have been assumed for this example.

After Year 3, the table below shows that the person has \$63,750 in their SAVA account, but only \$52,500 accessible to draw down on.

Gross Income	Net Income	Tax Brackets	SAVA ACCOUNT	Accessible
\$ -		45%	\$ -	\$ -
\$ -		40%	\$ -	\$ -
\$ 75,000		30%	\$ 63,750	\$ 52,500
\$ -		15%	\$ -	\$ -
	\$ -	Undeducted Contributions Earnings	\$ -	\$ -
			\$ 63,750	
				\$ 52,500 Cash in Hand
				\$ - Added to taxable Income
				\$ - Tax Credit (Tax Paid)

The following table shows after the year of unemployment. The equivalent of \$25,000 gross income has been drawn down. This \$25,000 would be taxed at 30% by the fund manager, leaving \$17,500 for expenses. The remaining SAVA account balance is \$42,500 or \$35,000 that is accessible.

Gross Income	Net Income	Tax Brackets	SAVA ACCOUNT	Accessible
\$ -		45%	\$ -	\$ -
\$ -		40%	\$ -	\$ -
\$ 50,000		30%	\$ 42,500	\$ 35,000
\$ -		15%	\$ -	\$ -
	\$ -	Undeducted Contributions Earnings	\$ -	\$ -
			\$ 42,500	
				\$ 35,000 Cash in Hand
				\$ - Added to taxable Income
				\$ - Tax Credit (Tax Paid)

The following table shows the balance at the end of the 7th year, where a further 3-year contract was obtained and \$25,000 per year was salary sacrificed. This person after 7 years would have \$106,250 in their SAVA account and approximately \$22,950 in Super Guaranteed payments.

Gross Income	Net Income	Tax Brackets	SAVA ACCOUNT	Accessible
\$ -		45%	\$ -	\$ -
\$ -		40%	\$ -	\$ -
\$ 125,000		30%	\$ 106,250	\$ 87,500
\$ -		15%	\$ -	\$ -
	\$ -	Undeducted Contributions Earnings	\$ -	\$ -
			\$ 106,250	
				\$ 87,500 Cash in Hand
				\$ - Added to taxable Income
				\$ - Tax Credit (Tax Paid)

As this example shows, this person has the flexibility and confidence to salary sacrifice 50% of their gross salary knowing that it can be drawn down in periods of unemployment. Without that flexibility, voluntary contributions would end up as post-tax investments in savings accounts, managed funds and mortgages that effectively provide a lower retirement balance.