1c Kenilworth Street,
Bondi Junction NSW 2022

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

By email to simplersuper@treasury.gov.au

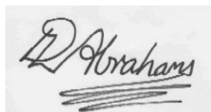
Dear Sir,

I am pleased to provide you with my submission on aspects of the Government's proposed changes to superannuation as outlined in *A Plan to Simplify and Streamline Superannuation—Detailed Outline* (the "Simpler Super plan").

While I have been working in the superannuation industry for over a decade, this submission is limited to key aspects of the proposals as they affect a typical family, such as mine, living in Sydney. This is a personal submission and does not represent the views of my employer or any organisation.

I would be pleased to provide further information in relation to any of my comments on request.

Yours sincerely,



Derek Abrahams
Ph: 02 9223 2010 (bh)
Email: derekabrahams@pfsnet.com.au

Submission—Simpler Super

1. Co-contribution

The Government introduced the co-contribution scheme to encourage and assist low-medium income earners to save for their retirement in the superannuation system.

The scheme currently includes a number of anomalies leading to a bias against families, particularly when a mother takes time out of the workforce to raise a family. This bias appears to be unintended and against the government's policies to encourage retirement savings by women and to encourage families.

Historically, the co-contribution has not been available to the self-employed, including the "substantially self-employed" which includes all people who earns less than 10% of their income as employees, regardless of the level of their income.

The Simpler Super plan includes a proposal to remove this inequity by extending the co-contribution scheme to the self-employed from 1 July 2007. However it limits the correction to individuals who "earn 10 per cent or more of their income from carrying on a business, eligible employment or a combination of both".

In other words, the inequity will be retained for individuals who are neither in paid employment nor carrying on a business, such as women who take maternity leave or leave the workforce to raise children. In addition to a loss in employer superannuation contributions for one spouse and a reduction in family income at a time when expenses increase, the unavailability of the co-contribution further reduces the eventual retirement income available to the family.

The following example demonstrates how the current co-contribution scheme can fail a family in suburban Sydney in a situation which must occur regularly. My wife inadvertently became ineligible for the co-contribution last year in similar circumstances.

> *Example*
> A woman on average weekly earnings[1] of $702 resigns at the end of July for maternity leave and an extended period out of the workforce to raise a family. She has earned four week's income from employment during that financial year (i.e. $2,808). She also has an investment of $300,000 as a result of the family saving for a number of years to buy a house. At the end of the year, the family takes out a $500,000 mortgage which allows them to buy an $800,000 house in inner Sydney after cashing the $300,000 investment. The investment earned income of 9% during the year (i.e. $27,000).
>
> Although her annual income is within the co-contribution income limits and is well below average earnings, the woman is ineligible for the superannuation

[1] Source: Australian Bureau of Statistics publication 6302.0 *Average Weekly Earnings, Australia, Feb 2006*. Total earnings for females in NSW (trend estimates) (Series ID A596238A)

co-contribution as she has earned less than 10% of her income as an employee and so is classed as “substantially self-employed”.

If she had worked one more week before commencing maternity leave, or if the money she had invested for her home deposit had only earned 8%, she would have received the co-contribution.

Currently, eligibility for the co-contribution is linked to a person’s eligibility to receive a tax deduction for superannuation contributions as “self-employed” or “substantially self-employed”, regardless of whether or not the person claims the deduction. Unlike the co-contribution which is paid automatically by the Australian Taxation Office, the taxpayer must apply for a tax deduction and advise the superannuation fund which holds the contributions accordingly.

In any case, it is of negligible benefit for people on lower incomes to make a superannuation contribution and claim it as a deduction. In fact, those on a marginal tax rate of 15% are worse off by making this type of superannuation contributions as the saving in personal income tax from the deduction is exactly matched by the 15% contributions tax on receipt by a superannuation fund, but the money becomes preserved and so unavailable for any urgent needs. For those on a marginal tax rate of 30%, the saving in personal income tax from the deduction is largely offset by contributions tax and will be completely matched by contributions tax and benefits tax if the final cash benefit is above the tax-free threshold (under the Simpler Super plan, only if the benefit is cashed between ages 55 and 59).

Recommendation 1 The co-contribution scheme should be based solely on the income test. In other words, it should extended to cover all individuals including non-working mothers. Similarly, students and unemployed individuals should be eligible for the co-contribution.

Recommendation 2 If the previous recommendation is not accepted, the government should consider allowing “substantially self-employed” individuals to elect whether to claim a co-contribution or a tax deduction for superannuation contributions.

Recommendation 3 The Government should consider making retrospective co-contribution payments in respect of contributions made since July 2003 by individuals in circumstances as described in the example above (i.e. those who met the standard income test for co-contributions but were classed as self-employed or substantially self-employed).

Contribution limits

The Simpler Super includes two proposals to introduce limits on superannuation contributions:

- a limit of $50,000 (with a short transitional period allowing contributions up to $100,000 for individuals aged 55+) on deductible contributions and
- a limit of $150,000 (or $450,000 over three years) for personal, undeducted contributions.

The level and timing of these limits are not suitable for a typical family for a number of reasons.

Firstly, a typical family can only afford to make substantial additional superannuation contributions after their children have finished their education and the family has paid off its home loan (mortgage). The limits do not allow for the reality that contributions will not normally be made at regular, even levels over a person's working life.

Worse, individuals aged over 50 will have the maximum level of deductible contributions (including employer and salary sacrifice) more than halved from the current limit of $105,113 p.a. to $50,000 p.a just when they are at the stage of their lives when they may be able to afford substantial additional contributions to top-up their superannuation retirement savings.

Secondly, the high level of real estate prices in capital cities, particularly Sydney, means that many families have the majority of their investment savings locked up in the family home.

For example, considering a person who moved from a house suitable for a family into a smaller unit after his children grew up and left home. Currently, the difference realised could be put into superannuation as an undeducted contribution to fund retirement. At current Sydney real estate prices, this could easily be over $450,000. The proposed limit on undeducted contributions would only allow this contribution if it was split into 2 payments made three years apart.

Recommendation 4 Averaging of contribution limits should be allowed over a much longer period (e.g. 10 years or lifetime averaging). Alternatively, or in addition, contribution limits could be increased substantially, particularly for individuals aged over 50.

The contribution limits apply to individuals. This is not suitable for a family with only one full-time income, as retirement savings will need to support both spouses. Already there is a bias against families where many social security benefits are based on combined assets and income for both spouses while income tax is paid on an individual basis. For example, based on 2005-06 income tax rates, a family with gross income of $100,000 will pay income tax of $30,550 from a single income, which is considerably more than the $21,720 tax which they would pay from two incomes of $50,000 each.

Recommendation 5 Couples should be given contribution limits double those applying for singles. Alternatively, the contribution limits should be set at an appropriate level to allow sufficient contributions to support a couple in retirement.

The introduction of a limit for undeducted (personal) contributions to superannuation can also lead to an unfair situation if a person becomes disabled, a time when they will need additional help and support. Currently, a person who receives a cash payment in relation to disablement (e.g. from a workers' compensation or other non-super insurance claim) can arrange regular income by transferring the proceeds into superannuation to purchase a pension or annuity. The Simpler Super plans would

hinder this by limiting the contribution to super to $150,000 (or $450,000 over three years). If a person has already made some personal contributions, the amount of the disablement payment which could be transferred to the pension or annuity would be further limited.

Recommendation 6 The limit on undeducted contributions should not apply to lump sum disability payments being transferred into a superannuation fund.

The Simpler Super plans do not include any proposal to retain the real value of the contribution limits. They should be indexed annually (or increased regularly by some other means).

Recommendation 7 Contribution limits should be indexed.

Tax on disability benefits

Insurance is an important part of a family's financial arrangements, supporting a family in need by paying off its mortgage and providing an income in the situation when the breadwinner is incapacitated or dies.

The Simpler Super plans do not address a significant inequity in relation to disablement benefits paid from superannuation funds.

Life insurance payments under policies held outside superannuation are tax-free; the same payment within the superannuation system is usually taxed, at a rate of up to 20%. (The amount of taxation depends on the person's age, length of employment and total superannuation benefit, but not on the insured amount).

The Simpler Super plan does not address disablement benefits directly; although it does remove all benefit tax for individuals aged over 60.

In other words, while superannuation funds can often provide insurance at nominally lower premiums, a larger amount must be insured to receive the same after-tax payment.

There does not seem to be any substantial policy reason for continuing the current inequity on taxation of disablement benefits: there is almost no chance of the system being abused as all superannuation fund benefits are preserved until retirement age unless the fund member meets the strict Superannuation Industry (Supervision) Act definition of Permanent Incapacity.

Recommendation 8 Benefits paid as a result of Permanent Incapacity should be tax-free regardless of the age of the member.