

ASFA Pre-Budget Submission for the 2017-18 Budget

January 2017

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About ASFA

ASFA is a non-profit, non-political national organisation whose mission is to continuously improve the superannuation system so people can live in retirement with increasing prosperity. We focus on the issues that affect the entire superannuation system. Our membership, which includes corporate, public sector, industry and retail superannuation funds, plus self-managed superannuation funds and small APRA funds through its service provider membership, represent over 90 per cent of the 14.8 million Australians with superannuation.

Executive summary

The superannuation system is delivering considerable benefits for individuals, the government budget (in terms of reduced Age Pension expenditures) and for the Australian economy through increased domestic savings and investment. These benefits will continue to increase as the system heads towards maturity.

Government assistance for retirement income in Australia is sustainable going forward. Government expenditure, in the form of Age Pension and tax expenditures on superannuation, is low by both historical Australian standards and relative to expenditure in other countries. As well, ASFA projections indicate that such expenditures, in terms of percentage of GDP, will be relatively stable going forward over the next few decades.

ASFA considers that given substantial changes to the taxation of superannuation and the provision of the Age Pension in recent years, including in the 2013-14, 2014-15 and 2016-17 Budgets, there should now be a period of consolidation to allow the various changes to be bedded down.

It is recommended that any further substantive changes to either superannuation or the Age Pension only be made after there has been a holistic consideration of retirement incomes policy in the context of the Intergenerational Report (IGR). ASFA also recommends that to restore and maintain public confidence in our superannuation system, all substantive reviews and potential changes to superannuation and related retirement incomes policy be aligned to the IGR cycle; that is, every five years. The next such Review is not likely to be undertaken until early 2020.

It is also suggested that this holistic process review the structure of the means test for the Age Pension.

However, the strengths of existing policy settings could be built upon by a number of relatively modest and affordable enhancements in this Budget.

Recommendation 1:

ASFA recommends that no further adverse changes be made to superannuation tax provisions or to the Age Pension without a holistic review being undertaken in the context of, and aligned to, scheduled Intergenerational Reports.

Notwithstanding the current review of the financial services external dispute resolution framework, ASFA considers that the Superannuation Complaints Tribunal (SCT) needs to be provided with sufficient resources to undertake the timely consideration and resolution of complaints. Building on the funding provided in the 2016-17 Budget, ASFA considers that the SCT needs to be provided with specific, non-recurrent, funding in the 2017-18 Budget to allow the SCT to appropriately deal with the existing backlog of complaints, pending the outcome of the more general financial sector dispute resolution mechanisms.

Recommendation 2:

ASFA recommends that:

- a) The amount of funding allocated to the SCT from the ASIC component of the 2017-18 supervisory levy should be separately considered, identified and made, and
- b) Treasury and ASIC should urgently review the SCT's current funding needs to ensure it is adequately resourced to address both its existing and anticipated future workload and to meet its statutory objectives.

Given recent changes to superannuation reporting requirements that have enhanced the information held by the Australian Taxation Office (ATO) about superannuation accounts, ASFA considers that the ATO should be empowered to initiate the repatriation of lost member accounts rather than just respond to member requests. Such a change would be consistent with the policy objective of reducing the number of unnecessary accounts within the superannuation system.

While interest is paid at the CPI rate on amounts held by the ATO, a member, with a balance greater than \$2,000, is better off in an average fund's default investment option (based on long term average investment returns and fees).

Recommendation 3:

ASFA recommends that priority be given to amending the *Superannuation (Unclaimed Money and Lost Members) Act 1999 Act* so as to permit the Commissioner of Taxation to pay unclaimed money to a complying superannuation plan where the Commissioner is satisfied as to the identity of the lost member account owner and that the person holds an account in the proposed active destination fund.

The Australian National Audit Office (ANAO) has found that audits undertaken by the Australian Taxation Office have an excess of 70 per cent success rate in identifying SG obligations.

The ANAO has also noted that most of the compliance resources of the ATO's Superannuation Business Line (SBL) are dedicated to addressing employee notifications of potential SG non-compliance. While some audits are conducted by the Superannuation Business Line, the number is small.

ASFA contends and recommends that a greater focus and application by the SBL to audits would result in better long-term outcomes for Australians who are not presently receiving their superannuation guarantee entitlements from their employers.

ASFA believes that additional funding of \$10 million per year applied across the 2017-18 forward estimate period (ie, 4 years) would materially improve and address this situation.

Recommendation 4:

ASFA recommends that the Australian Taxation Office be provided with an additional \$10 million a year to conduct Superannuation Guarantee audits of businesses.

The treatment of unpaid superannuation in the case of an employer insolvency/bankruptcy is currently subject to a complex combination of legislative provisions.

In ASFA's view, there is merit in reviewing the treatment of unpaid SG entitlements in insolvency/bankruptcy, with the objective of considering how to achieve the maximum possible recovery on behalf of affected employees. ASFA estimates that it would cost around \$150 million per year to include unpaid SG in the Fair Entitlements Guarantee

administered by the Australian Government, with around 55,000 affected individuals standing to benefit from this initiative.

Recommendation 5:

ASFA recommends that unpaid SG entitlements be included in the definition of unpaid employment entitlements for the purposes of the Fair Entitlements Guarantee.

ASFA is strongly supportive of a superannuation industry that is competitive and that is continuously improving its efficiency and productivity.

Mergers of funds, generally effected through a 'successor fund transfer', can be a means by which funds can realise efficiencies of scale. The absence of ongoing capital gains tax (CGT) relief can act as a significant barrier to fund mergers as a fund merger generally triggers CGT events.

In determining whether to merge with another fund, a trustee of a superannuation fund is under a fiduciary duty to act in the best interests of the members of the fund. As such, the threshold decision as to whether or not to merge is made taking into consideration the various benefits and costs to members of the potential merger – including the effect of CGT.

ASFA consistently has supported the position that the tax legislation should provide permanent CGT relief for mergers of superannuation funds, equivalent to that in Division 310 of the Income Tax Assessment Act 1997. In the context of the current work by the Productivity Commission on efficiency, there is an opportunity for the Federal Government to address a barrier to mergers by providing permanent CGT relief.

Recommendation 6:

ASFA recommends that the tax legislation should provide permanent CGT relief for mergers of superannuation funds, equivalent to that in Division 310 of the *Income Tax Assessment Act 1997*.

Reinforcing public confidence in the retirement income system

ASFA considers that given substantial changes to the taxation of superannuation and the provision of the Age Pension in recent years, including in the 2013-14, 2014-15 and 2016-17 Budgets, there should now be a period of consolidation to allow the various changes to be bedded down.

This position is supported by the views of Australians. In a survey of over 1,000 Australians commissioned by ASFA and conducted in October 2016:

- 54 per cent of respondents agreed with the statement that superannuation is a good way to save for retirement, however, 47 per cent also indicated that the Government makes too many changes to the rules for superannuation
- 34 per cent of respondents indicated that they considered that superannuation is taxed too much
- Only 3 per cent of respondents considered that superannuation is taxed too little
- Only 9 per cent of respondents indicated that they would be willing to rely on just the Age Pension alone
- Around 25 per cent of respondents indicated that the recent changes to the taxation of superannuation had reduced their confidence in superannuation
- Only 17 per cent of respondents considered that there should be any further changes to superannuation in the next five years
- 63 per cent of respondents strongly supported or somewhat supported the eventual increase of the Superannuation Guarantee (SG) to 12 per cent of wages, with over 25 per cent of respondents somewhat opposed to or strongly opposed to the current pause in regard to increases in the SG

Support for compulsory superannuation was particularly strong amongst those aged 40 and over.

Although the recent superannuation tax changes are targeted at individuals on higher incomes and relatively high account balances and/or those making larger contributions, significant proportions of the population consider that the changes will impact on them personally over the next ten years:

- 21 per cent of respondents indicated that they expected that the reduction in concessional contribution caps would impact on them personally in the next ten years
- 12 per cent indicated they would be impacted by the reduction in the non-concessional cap to \$100,000 a year

- 12 per cent also indicated that they considered they would be affected by the \$1.6 million cap for totally tax free superannuation investment earnings in retirement
- 22 per cent of respondents indicated that they would be affected by the changes to transition to retirement pension arrangements

While in reality the proportion affected by the various measures might be lower than indicated by the expectations of respondents, the results indicate that a very substantial minority of Australians consider that the changes are directly relevant to them.

Discussions and debate about the future of Australia's retirement incomes policy need to be had in a much broader context than the short term impact on the Budget and with input from industry, stakeholders and the broader community. All Australians should be given the opportunity to state what they want their retirement to look like in the future and the policies required to achieve it.

Superannuation is just one component of such policy review. The role of other factors such as aged care, health care and access to the Age Pension must also be considered when contemplating the system's design.

Policy decisions in regard to both superannuation and the Age Pension will have an impact on the lifestyle of all Australians in retirement. Superannuation tax settings and Age Pension arrangements should not be the product of a short term Budget process with little or no prior consultation or public analysis. A national consensus on how Australia's superannuation system will look in the future, drawing on feedback and ideas from a broad range of stakeholders in the community is needed.

As shown by the following table, many Australians are now retiring with significant superannuation balances. Many singles and perhaps most couples who are recent retirees from the paid labour force and have reached the qualifying age for the Age Pension will have assets sufficient to be affected by the assets test for the Age Pension.

Table 1: Mean and median superannuation balances of those who have recently retired from the labour force, 2014

Age group			
	% with superannuation	Superannuation balance (\$)	
		Mean	Median
Men			
<60	*66.4	249,324	150,000
60–64	*79.3	450,748	480,000
65–69	67.9	345,758	200,000
70+	47.2	424,423	420,000
Total	66	381,984	300,000
Women			
<60	70.3	252,046	125,000
60–64	69.4	432,838	250,000
65–69	41	369,099	250,000
70+	*58.6	*549,637	*200,000
Total	60.1	367,707	200,000

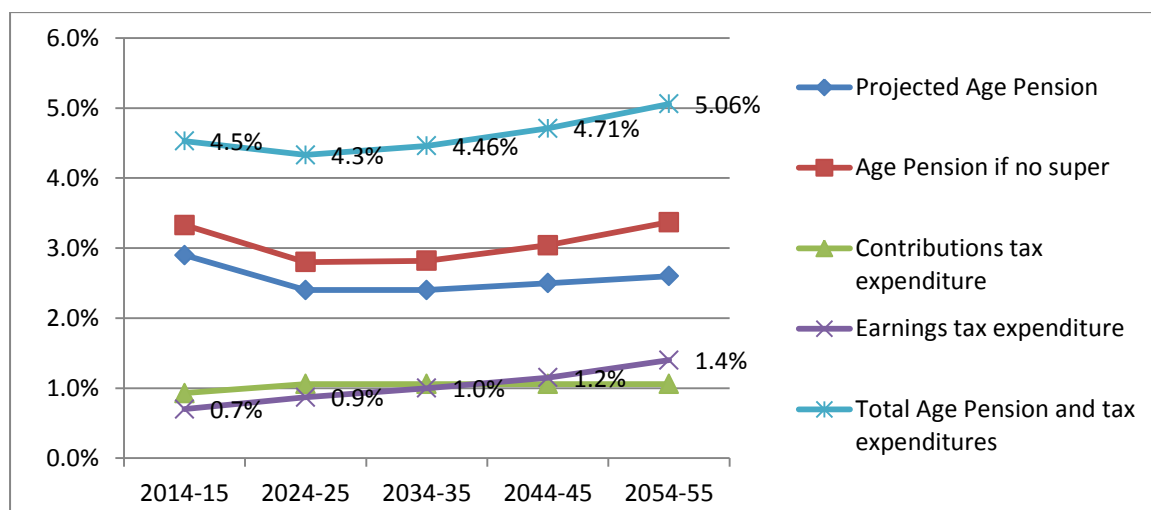
* Estimate not reliable. 'Recently retired' if 'currently retired and observed not retired (i.e., employed) at some stage in the last three years'.

Source: HILDA unit record data extracted for ASFA.

Australia is unusual in international terms in regard to having a means test for publicly provided retirement incomes. The means test in conjunction with growing average superannuation balances means that Age Pension expenditures will be largely stable as a percentage of GDP over the next 40 years. The phased increase in the eligibility age for the Age Pension also will play a role in containing Age Pension expenditures.

As shown by Chart 1, despite an ageing population structure in Australia, total government assistance for retirement income is projected to grow only modestly in terms of percentage of GDP.

Chart 1: Age Pension expenditure and tax expenditures on superannuation as a percentage of GDP



The combination of a means tested government funded Age Pension and a tax assisted compulsory superannuation system means that projected direct and tax expenditures for retirement saving will be below, in some cases substantially below, projected direct expenditure for public income support for the aged in other developed countries.

Table 2: Projected government expenditure on income assistance to the aged, per cent of national GDP

	2010-2015	2020	2025	2030	2035	2040	2045	2050	2055	2060
Australia	2.9		2.5		2.5		2.6		2.7	
United Kingdom	7.7	7.4	7.8	7.9	8.2	8.4	8.1	8.1	8.3	8.4
United States	4.9							6.1		
Canada	4.9							6.3		
France	14.9	14.6	14.9	14.7	14.2	13.8	13.3	12.8	12.3	12.1
Germany	10.0	10.3	10.9	11.6	12.1	12.2	12.3	12.5	12.6	12.7
New Zealand	5.5							7.3		
OECD	8.6							9.6		11.1

Both in absolute terms and relative to other countries it could be argued that current government support for retirement income is sustainable and will continue to be sustainable for the foreseeable future.

ASFA notes a significant number of Australians are impacted by the recent Age Pension means test changes and a considered review by government, including appropriate public

consultation, should be undertaken in regard to the structure of the means test before any further changes are made.

In the same context, the lack of an agreed clear and unambiguous framework for the design of the means test for the Age Pension also means that there will be challenges for government in developing appropriate means test arrangements for new financial products designed to provide protection against the financial consequences of longevity.

Accordingly, ASFA recommends that any further substantive changes to either superannuation or the Age Pension only be made after there has been a holistic consideration of retirement incomes policy in the context of the Intergenerational Report. We understand the next IGR is scheduled for early 2020.

Recommendation 1:

ASFA recommends that no further adverse changes be made to superannuation tax provisions or to the Age Pension without a holistic review being undertaken in the context of, and aligned to, scheduled Intergenerational Reviews.

The remainder of this pre-Budget submission addresses a number of relatively modest proposals aimed at enhancing the current superannuation system.

Providing adequate funding for the Superannuation Complaints Tribunal (SCT)

Timely and efficient dispute resolution in regard to decisions and conduct of trustees and insurers of superannuation funds is important for the effective operation of the superannuation system and for consumer confidence in the system.

The SCT is a service of critical importance to APRA-regulated superannuation funds and their members and the time taken to resolve complaints is an issue which impacts on consumers' confidence in the superannuation system.

A panel led by Professor Ian Ramsay is currently reviewing the financial system's external dispute resolution and complaints framework, including the SCT (Ramsay Review). The Review is not due to provide its final report until 31 March, and any reforms the Government elects to make in response are likely to take some time to implement. As a result, there is an immediate need to deal with the current backlog of cases before the SCT.

In this context ASFA welcomed the Government's announcement on 20 April 2016 that the SCT would be provided with an ad hoc funding increase of \$5.2 million to deal with legacy complaints and improve its processes and infrastructure. However, in ASFA's view the one-off nature of the 2016-17 funding injection does not adequately address the deficiency in funding of the SCT's ongoing needs.

Submissions to the Ramsay Review demonstrate that consistent underfunding of the SCT has created a situation where complaints backlogs inevitably build up. In contrast funding should be determined on the basis of consideration of complaint volumes. Additional funding is also needed to automate and improve internal processes and systems which currently are inefficient and largely manual in nature.

ASFA strongly urges Treasury and ASIC to urgently review the SCT's funding needs to ensure it receives adequate resources on an ongoing basis to address its workload and meet its statutory objectives, without the need to rely on ad hoc funding increases.

Recommendation 2:

ASFA recommends that:

- a) The amount of funding allocated to the SCT from the ASIC component of the 2017-18 supervisory levy should be separately considered, identified and made; and
- b) Treasury and ASIC should urgently review the SCT's current funding needs to ensure it is adequately resourced to address both its existing and anticipated future workload and to meet its statutory objectives.

Small inactive superannuation accounts and unclaimed monies

As a result of decisions by the current and previous government, the threshold below which small inactive superannuation accounts are required to be transferred to the Australian Taxation Office has been increased from \$2,000 to \$4,000 from 31 December 2015, and to \$6,000 from 31 December 2016.

The stated aim of the measure is to protect the real value of these small transferred accounts. While the aim of protecting account balances may be appropriate for account

balances under \$2,000, there is far less certainty about the need for such protection under the higher thresholds.

While interest will be paid at the CPI rate on amounts held by the ATO, for a member invested in a fund's default investment option, based on long term average investment returns, it is probable that for account balances greater than \$2,000 the member would be better off financially were the account balance to remain invested in an active superannuation account held by the member.

A further concern is that these higher account balances are more likely to hold insured benefits. There is also an increased likelihood that the member has consciously maintained an account for the explicit purpose of retaining insurance through that account. A significant number of superannuation funds, under their partial portability rules, have a "retained balance" threshold – generally around \$5,000 – which insured members avail themselves of in order to retain insurance cover through their account. Some funds will also allow members to let their account balance fall below the threshold before they require them to top up the account in order to retain the insurance cover.

Whilst the ATO is active in identifying and contacting account owners and encouraging them to consolidate these lost accounts with their other superannuation holdings, the amount of superannuation held by the ATO as unclaimed or as small and inactive continues to grow. The number of such accounts grew from 3.8 million in 2014-15 to 4.1 million, with the aggregate balances growing from \$2 billion to \$2.5 billion. In most cases the individuals concerned will have a superannuation account that is active and which they are aware of.

Given recent changes to superannuation reporting requirements that have enhanced the information held by the Commissioner in regard to superannuation accounts, ASFA considers that the opportunity should be taken to amend section 24G of the SUTLM Act to empower the Commissioner to initiate the repatriation of lost member accounts.

Recommendation 3:

ASFA recommends that priority be given to amending the *Superannuation (Unclaimed Money and Lost Members) Act 1999 Act* so as to permit the Commissioner of Taxation to pay unclaimed money to a complying superannuation plan where the Commissioner is satisfied as to the identity of the lost member account owner and that the person holds an account in the proposed active destination fund.

Enforcement of the Superannuation Guarantee

While we note and welcome the increased focus from the ATO, the non-payment of SG contributions by employers is a critical issue impacting on the retirement outcomes of Australians.

Reports prepared by Tria Investment Partners show an increase in SG non-compliance, and the significant impact that this can have on the retirement outcomes of affected employees. In particular:

- SG non-compliance was assessed to be a \$2.5 billion per annum problem in the 2014 Tria report, rising to \$2.6 billion per annum in the 2015 Tria report.
- The number of Australians affected by SG non-compliance is growing. The 2015 Tria report found that around 690,000 Australians – 6.5% of the workforce – were affected by SG non-compliance annually.
- The impact on Australians affected by SG non-compliance is significant. The 2015 Tria report found that Australians affected by non-compliance lost an average of \$3,800 per annum in SG contributions – 9 months' worth for someone on average weekly earnings, more for low income earners.
- The cumulative impact of this loss on Australians' retirement outcomes is also substantial. An average 25 year old impacted by SG non-compliance for 5 years loses 14% of their retirement income - \$8,000 per annum. ASFA estimates show that for a 25 year old, a one-off loss of \$4,000 in superannuation contributions could equate to a loss of over \$14,000 at retirement, in today's dollars.

SG non-compliance is clearly a serious issue, one which represents a significant risk to the retirement security of a large number of Australians.

In this context ASFA considers that dealing with SG non-compliance should be more highly prioritised within the ATO and that the relevant areas within the ATO be more appropriately funded.

In encouraging compliance, the ATO has predominantly focussed on communicating recent legislative changes affecting SG.

A relatively recent ANAO audit report on ATO activity in regard to SG compliance notes that most of the compliance resources of the ATO's Superannuation Business Line are dedicated to addressing employee notifications of potential SG non-compliance. While some audits are conducted by the Superannuation Business Line, the number is small when compared to those undertaken by the Small Business and Individual Taxpayer business lines.

The ANAO found that audits undertaken by the three business lines have in excess of 70 per cent success rate in identifying SG obligations. Accordingly, the ANAO recommended that to improve the effectiveness of the ATO's SG compliance activities, the Superannuation Business Line should better align its SG compliance strategy with the compliance activities undertaken by other relevant business lines.

More recent information provided by the ATO indicates that the proportion of SG compliance cases arising from ATO initiated activity has increased, reaching 30 per cent of total cases in 2015-16.

ATO initiated cases identified non-payment of SG in 82 per cent of ATO initiated cases, and resulted in higher adjustments to SGC than employee notification cases with an average adjustment \$68,000 per employer. The high SG "strike rate" for ATO initiated cases suggests that a further expansion of this activity would lead to recovery of superannuation contributions for a large number of employees.

The ATO also has a greater chance of collecting unpaid SG from employers who are currently in business and solvent. In 2015-16 some 36 per cent of employee notifications related to employers who demonstrated indications of insolvency. As well, the ATO generally has difficulty addressing unpaid SG entitlements more than five years old given that employers are not generally required to keep records for more than five years.

Recommendation 4:

ASFA recommends that the Australian Taxation Office be provided with an additional \$10 million a year to conduct Superannuation Guarantee audits of businesses.

Superannuation payments owed by insolvent employers

The Fair Entitlements Guarantee (FEG) provides for the Commonwealth to pay an 'advance' on account of certain unpaid 'employment entitlements' in cases where an individual's

employment ended in circumstances connected with the insolvency or bankruptcy of their employer and the individual cannot obtain payment of their entitlements from other sources.

The treatment of unpaid superannuation in the case of an employer insolvency/bankruptcy is currently subject to a complex combination of legislative provisions, including the Superannuation Guarantee (Administration) Act 1992, the Corporations Act 2001, the Bankruptcy Act 1966, and the 'director penalty notice' provisions of the Taxation Administration Act 1953.

The types of 'employee entitlements' currently covered by the FEG are limited, and do not include unpaid superannuation contributions. However, the entitlements that can be claimed include forms of employee remuneration not dissimilar to superannuation contributions:

- unpaid wages—up to 13 weeks
- unpaid annual leave and long service leave
- payment in lieu of notice—up to five weeks
- redundancy pay—up to four weeks per full year of service.

The Australian Taxation Office has indicated that some 50 per cent of superannuation debts that they deal with relate to insolvency.

In ASFA's view, there is merit in reviewing the treatment of unpaid SG entitlements in insolvency/bankruptcy, with the objective of considering how to achieve the maximum possible recovery on behalf of affected employees. ASFA estimates that it would cost around \$150 million per year to include unpaid SG in the FEG, with around 55,000 individuals affected.

Recommendation 5:

ASFA recommends that unpaid SG entitlements be included in the definition of unpaid employment entitlements for the purposes of the Fair Entitlements Guarantee.

Capital Gains Tax (CGT) rollover relief for mergers of superannuation funds

ASFA consistently has supported the position that the tax legislation should provide permanent CGT relief for mergers of superannuation funds, equivalent to that in Division 310 of the Income Tax Assessment Act 1997.

There are four main reasons why consideration should be given to providing permanent CGT relief:

1 The barrier to fund mergers is virtually insurmountable during any periods where the closing fund's balance sheet is in a deferred tax asset ("DTA") position, and continues to be a potential impediment in present times where the closing fund's balance sheet is in a deferred tax liability ("DTL") position. In September 2016 APRA regulated funds had a total of \$672 million in deferred tax assets.

2 It is not considered that permanent relief would represent an overall cost to revenue, as in the short term the absence of relief may preclude mergers from occurring, and in the medium to long term mergers will result in a more efficient industry which would deliver higher revenues and broader economic benefits to the community.

3 Permanent relief would be consistent with the broad structure of Australia's CGT provisions, as comparable relief is available to corporate mergers and for a range of other business reorganisations.

4 The absence of permanent relief means this issue must be revisited in conjunction with Government initiatives to encourage fund consolidation – ad hoc temporary relief has the potential to create significant inequities between members of funds that merge during periods of relief and funds that merge when there is no relief.

Recommendation 6:

ASFA recommends that the tax legislation should provide permanent CGT relief for mergers of superannuation funds, equivalent to that in Division 310 of the Income Tax Assessment Act 1997.